NO. 74-529

MICHAEL RODAK, JR., CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1974

PAT RYAN & ASSOCIATES, INC.,

Petitioner,

vs.

OCCIDENTAL LIFE INSURANCE COMPANY OF NORTH CAROLINA,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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NO.

PAT RYAN & ASSOCIATES, INC.,

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VS.

OCCIDENTAL LIFE INSURANCE COMPANY OF NORTH CAROLINA,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fourth Circuit entered in the above-entitled cause on May 8, 1974.

OPINIONS BELOW

The opinion of the Court of Appeals is officially reported at 496 F.2d 1255 (1974), is unofficially reported at 1973-74 CCH Fed. Sec. L. Rep. ¶94,551 (1974) and is printed at pages 1a-23a of Appendix A to this petition, *infra*. No District Court opinion has been reported. The opinions of the District Court that accompanied those of its orders that are pertinent to this petition are printed at pages 25a-36a of Appendix A to this petition, *infra*.

JURISDICTION

The judgment of the Court of Appeals was entered on May 8, 1974. A timely petition for rehearing was denied June 24, 1974. The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

QUESTIONS PRESENTED

The decisions below raise two important questions of federal law that merit this Court's consideration because they have been resolved in conflict with decisions of this Court and other Courts of Appeals. We ask this Court to consider:

(1) Whether Section 29(b) of the Securities Exchange Act of 1934 precludes an action for breach of a contract for the sale of securities by a seller who, in violation of the Act, has defrauded the purchaser.

(2) Whether, by adopting an improper standard and procedure for review of a trial court order vacating a jury's damage award and ordering a new trial, the court below sanctioned a wrongful invasion of the province of the jury and a deprivation of petitioner's constitutional right to a trial by jury.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The constitutional provision involved in this case is Amendment VII to the Constitution of the United States.

The statutory provisions involved are Sections 10(b) and 29(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b) and 15 U.S.C. §78cc(b); and Rule 10b-5, promulgated under §10(b), 17 C.F.R. §240.10b-5.

These provisions are printed as Appendix B to this petition, *infra*.

STATEMENT OF THE CASE

Petitioner, a victim of fraud in the purchase of securities, seeks review in this Court of decisions below which held it liable to the seller in the net amount of $400,000 on the contract to purchase the stock involved. Denial to petitioner by the courts below of a statutory defense to the contract, and the validity of an order setting aside a jury's award of counterclaim damages in petitioner's favor are at issue.

In this litigation, Occidental Life Insurance Company of North Carolina sued the Petitioner, Pat Ryan & Associates, Inc. for breach of a contract arising out of the sale to Ryan of all of the stock of Virginia Surety Company, Inc., a wholly owned subsidiary of Occidental Life. Ryan counterclaimed for violations by Occidental Life of the federal securities laws in connection with the sale. The courts below specifically found that there was ample evidence to support the findings of two juries that Occidental Life had violated those laws. (A 11a, 31a.) [1]

The action was tried twice, and each time the District Court directed a verdict against Ryan on the complaint in the amount of $770,000. On the counterclaim, the first jury awarded Ryan $797,000; the District Court set that award aside and ordered a new trial. The second jury awarded Ryan only $379,000 and the trial court entered judgment for $400,000 in Occidental's favor. The Court of Appeals rejected the appeals of both parties and affirmed the judgment, except as to the award of interest.

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[1] Citations to the opinions and orders below that are printed in Appendix A to this Petition will appear herein as "A ....." Citations to the transcript of the first trial will appear as "Tr. I, Nov. 17, 1972, [e.g.] at ....." (References to dates of the first transcript are necessary because each day's copy is separately paginated.) Citations to the transcript of the second trial will appear as "Tr. II at ....."

The contract for the sale of the Virginia Surety stock called for a cash payment by Ryan of $1,527,000 at the closing in October, 1969, and execution by the parties of a reinsurance agreement that would provide Occidental Life $750,000 additional compensation for the sale over a three year period. This payment arrangement was reached as a compromise. Ryan viewed Occidental's asking price of $1,927,000 for the stock of Virginia Surety as more than the company was worth and was unwilling to pay that much for the stock. (Tr. I, Nov. 16, 1972, at 91-101.) However, the reinsurance agreement—under which Ryan was to produce insurance premiums for Occidental that it would have to produce for some carrier anyway in states where it was not licensed to write insurance directly[2]—established a continuing business relationship that would benefit Occidental in the amount of $750,000, but at no additional cost to Ryan. (A 3a.) Under the agreed arrangement, Ryan was able to purchase the stock for what it felt was a fair cash cost to it, and Occidental was put in the position of receiving additional compensation for the stock well above its asking price.

At the closing, the $1,527,000 payment was made to Occidental and the reinsurance agreement was signed. The controversy that would bring the parties before this Court began shortly thereafter. After the closing and continuing through the spring of 1970, Ryan learned of a number of important facts that had been misrepresented or concealed from it during negotiations for the sale and which bore directly on the value of the Virginia Surety stock.

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[2] Prior to the sale, Ryan was engaged in writing insurance in a limited number of states.

From a letter received shortly after the sale from the Connecticut Insurance Department revoking the license of Virginia Surety in that state, Ryan learned for the first time that examiners from the insurance departments of five states had conducted a tri-annual examination of Virginia Surety's condition in August and September of 1969, just weeks before the sale. (A 4a.) The report of that examination concluded that the financial statement of Virginia Surety of December 31, 1968, had underestimated the company's liabilities by over $600,000. The adjustment required to correct the error exhausted the company's surplus and impaired its capital as of that date. Virginia Surety accepted the report as written three days prior to the closing with Ryan. Not only had Occidental failed to inform Ryan during their negotiations that the examination of Virginia Surety had taken place, but the contract itself, written by Occidental, contained a provision disclaiming any knowledge on the part of Occidental of any governmental investigation which might adversely affect the sale. Furthermore, Occidental knew from the examination report that the December 31, 1968, financial statement of Virginia Surety it had provided Ryan was false and misleading. (Tr. I, Nov. 14, 1972, at 317.)

The revelations did not stop with the tri-annual examination report and the Connecticut license revocation. Ryan soon learned of restrictions that had been imposed prior to the sale on Virginia Surety's license to operate in North Carolina. Ryan also discovered that the previous owners of Virginia Surety had agreed with the insurance departments of Michigan and California that the company would write no further business in those states, in exchange for the licensing there of another Occidental subsidiary. Finally, the insurance department of Maryland followed Connecticut's lead and revoked Virginia's Surety license. (A 4a-5a.)

The discovery of these facts and their consequences made it apparent that the Virginia Surety stock was not the investment that had been bargained for. Ryan had wanted to purchase, as the court below noted, "an ongoing corporate enterprise with a good business reputation" (A 10a-11a); it did not get that.[3]

Accordingly, before beginning performance under the reinsurance agreement, Ryan sought to obtain compensation for the injuries that Occidental's actions had caused it. Occidental, however, rejected Ryan's attempt to settle the grievances amicably and, five months before Ryan's performance came due, initiated this lawsuit in the state court of North Carolina alleging failure to perform under the reinsurance agreement.

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[3] Although Occidental has attempted to minimize its misrepresentations and non-disclosures by focusing on the license difficulties alone, all expert witnesses—including those called by Occidental—agreed that the value of Virginia Surety had been significantly damaged far beyond the impairments to its licenses. For example, Richards D. Barger, former insurance commissioner of California and former President of the National Association of Insurance Commissioners, when asked his opinion of the effect of the adverse examination report on "future relationships with regulatory agencies of the States in which the company is licensed to do business," replied:

> Well, very unsalutory, very bad.
>
> . . . .
>
> [T]he taint of having its capital impaired . . . . persists for some period of time, depending upon the memories of the staff personnel of the insurance departments, notwithstanding whether the management changes or not. (Tr. II at 848-850.)

To the same effect was the testimony of Ralph F. Colton (Tr. II at 765-66), T. Nelson Parker (Tr. I, Nov. 15, 1972, at 112-15, 382-86), James Rutherford (Tr. I, Nov. 16, 1972, at 24-25), and Occidental witnesses Ernest A. Randolph (Tr. II at 1225-26) and Alfred J. Bohlinger (Tr. II at 1276-78).

After removing the action to the Federal District Court on grounds of diversity, Ryan filed an answer and counterclaim setting up the misrepresentations, omissions, and breaches that had occurred in connection with the sale of stock. The answer and counterclaim originally sounded in breach of contract and common law fraud, but later was amended to assert that the same fact allegations constituted violations of Sections 12(*2*) and 17(a) of the Securities Act of 1933, 15 U.S.C. 77*l*(2) and 15 U.S.C. 77q(a), and Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b), and Rule 10b-5 thereunder, 17 C.F.R. §240.10b-5.[4]

At the conclusion of the first trial, Ryan contended that the alleged violations of the securities laws and the prior breach by Occidental of the contract sued upon were a defense to the complaint. (Tr. I. Nov. 17, 1972, at 33-34.) The trial court rejected the contention and directed a verdict on the complaint in favor of Occidental, and against Ryan, in the amount of $770,000. The case was then submitted to the jury on the defendant's counterclaim, under instructions agreed to by both parties. (Tr. I, Nov. 17, 1972, at 147, 151.) The jury found in favor of Ryan in the amount of $797,000 in damages.

Two months later, the District Court entered an order that the verdict of the jury rendered in Ryan's favor on its counterclaim be set aside on the issue of damages because "so grossly contrary to the weight of the evidence as to be shocking to the conscience of the court." Its order did not particularize the grounds further. A new trial was

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[4] The District Court had jurisdiction of Occidental's breach of contract claim pursuant to 28 U.S.C. §1332(a) and jurisdiction of Ryan's claims under the federal securities laws pursuant to §22(a) of the Securities Act of 1933, 15 U.S.C. §77v(a), and §27 of the Securities Exchange Act of 1934, 15 U.S.C. §78aa.

ordered on all issues arising on the counterclaim, but the trial court refused to set aside its directed verdict in favor of Occidental on its complaint. (A 25a-26a.)

Ryan then filed a motion under Rule 54(b) for the entry of final judgment on Occidental's complaint so that an immediate appeal could be taken of the directed verdict. The District Court denied the motion, but it did set aside the verdict it had directed in Occidental's favor "upon further consideration in the light of the briefs subsequently submitted in connection with defendant's Rule 54(b) motion." (A 27a.) The case was then set for retrial on all the issues raised by the complaint, answer and counterclaim.

At the close of evidence in the second trial, the District Court again, however, directed a verdict against Ryan in the amount of $770,000 on Occidental's breach of contract claim. The jury again returned a verdict in favor of Ryan on the counterclaim but, acting pursuant to instructions changed from the first trial and objected to by Ryan (Tr. II, Apr. 28, 1973, at 137-153), the jury limited its verdict on the counterclaim to $370,000. The District Court entered judgment in favor of Occidental for the $400,000 difference between the court's directed verdict on the complaint and the jury's verdict on the counterclaim.

Both parties appealed the final judgment entered by the District Court. With the exception of a modification of the judgment with respect to the award of pre-judgment interest, the Court of Appeals affirmed. In its decision, the court below rejected Ryan's contentions that the District Court had committed reversible error in its new trial order following the first trial, in its damage instructions in the second trial, in directing a verdict in both trials in Occidental's favor on the complaint, and in denying Ryan the alternatively requested relief of rescission. Ryan's petition for rehearing was denied on June 24, 1974.

REASONS FOR GRANTING THE WRIT

This case presents two important issues for resolution by this Court, the first of which involves construction of §29(b) of the Securities Exchange Act of 1934. This provision declares void, as regards rights of the violator, contracts made in violation of that statute. The decision by the Court of Appeals below that §29(b) is not a contract defense overrides the statute, conflicts with decisions by the Courts of Appeals for the Seventh, Sixth, and Second Circuits, and ignores and misconstrues opinions of this Court. It has deprived Petitioner of a remedy clearly intended by Congress and has materially blunted the effectiveness of the Act.

The second issue involves Petitioner's constitutional right to a trial by jury and the question of the proper standard and procedure on review to be applied to a trial court's order setting aside a jury damage award and granting a new trial. The decision of the court below on this issue conflicts with those of the Courts of Appeals for the District of Columbia, Second, Third, Fifth, Sixth, and Eighth Circuits. This conflict and the important constitutional question of the amount of discretion allowed a trial court to vacate the findings of a properly-instructed jury because it would have weighed the evidence differently are ripe for resolution by this Court. The results below, we respectfully submit, appropriately call for exercise of this Court's power of supervision and its authority to settle the law.

I.

The Court of Appeals' Ruling That Section 29(b) of the Securities Exchange Act of 1934 Does Not Preclude an Action for Breach of Contract Against a Defrauded Purchaser of Stock Deprived Petitioner of a Remedy Expressly Provided by Congress.

As its first affirmative defense to Occidental's breach of contract complaint, Ryan set up the fraudulent misrepresentations and non-disclosures "more fully set forth in [its] counterclaim." Acting on the basis of what the lower court itself termed "ample evidence" (A 21a.), the juries in both trials concluded that the allegations of fraud were well-founded. But these issues were allowed to go to the jury only in connection with the counterclaim. With respect to Occidental's complaint, the trial court rejected Ryan's defense based on precisely the same operative facts and directed a verdict against it. The Court of Appeals affirmed.

We respectfully urge upon this Court that these rulings below cannot be squared with the unambiguous language of §29(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78cc(b), which provides that:

> Every contract made in violation of any provision of this chapter or of any rule or regulation thereunder . . . shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, or regulation, shall have made . . . any such contract. . . .

In *dicta*, this Court declared in *Mills* v. *Electric Auto-Lite*, 396 U.S. 375, 387 (1970), that the above-quoted "language establishes that the guilty party is precluded from enforcing the contract against an unwilling innocent party. . . ." The court below, however, took the position that

"[w]e do not think §29(b) has such a devastating meaning." (A 16a.) That position, we respectfully submit, was wrong and should be corrected. Moreover, it reads out of the statute a specific remedy intended by Congress and is flatly contradictory to the Seventh, Sixth, and Second Circuits' construction of this provision.

In a case almost identical to this one, *Sundstrand Corp.* v. *Standard Kollsman Industries, Inc.*, 488 F.2d 807 (7th Cir. 1973), the Court of Appeals for the Seventh Circuit held that §29(b) *does* provide a defense to an action on a contract for the sale of securities to the victim of violations of Rule 10b-5. In that case, plaintiff alleged violations of the Rule in connection with the sale to it of an option to purchase stock of the corporate defendant. One of the individual defendants, the previous owner of the stock option, counterclaimed on a contractual monetary obligation obtained in connection with the sale to plaintiff of the stock option. After reversing the trial court's dismissal of the complaint, the Court of Appeals went on to consider the effect of the alleged 10b-5 violation on the counterclaim for breach of contract. Relying on §29(b), the court held that the counterclaimant would not be entitled to a hearing on his contract claim if the plaintiff were successful in proving "that the contract sued upon was made in violation of the Securities Exchange Act of 1933 [sic]. . . . Its defense to [the] counterclaim will rise or fall with the outcome of the retrial of its fraud claim. . . ." 488 F.2d at 816.

The instant case, like *Sundstrand*, involves countervailing claims by the buyer and seller of securities. The seller seeks to enforce the monetary obligations of a contract entered into in connection with the sale. The buyer seeks to recover damages due it because of the seller's violation

of §10(b) and Rule 10b-5 in connection with the stock sale, and raises the same facts as a defense to the seller's contract action. The decisions of the Courts of Appeals in the two cases simply cannot be reconciled.

The Court of Appeals for the Sixth and Second Circuits have also held that §29(b) provides a contract defense. *Goldman* v. *Bank of Commonwealth*, 467 F.2d 439 (6th Cir. 1972), and *Serzysko* v. *Chase Manhattan Bank*, 409 F.2d 1360 (2nd Cir. 1969), *cert. denied*, 396 U.S. 904 (1969), involved nearly identical fact situations. In each case, a borrower who had fraudulently induced the defendant bank to make loans in violation of Regulation U [5] sued to recover damages caused him by reason of the loans. Defendant bank in each case counterclaimed on the loan agreement. In both cases, the plaintiffs were denied recovery because of their own deceitful conduct. But in each case, §29(b) was held to provide a defense to the bank's counterclaim based on the loan contract.

The ruling by the court below also misapplies decisions of this Court and frustrates the congressional purpose underlying the Securities Exchange Act.

In concluding that §29(b) "is but a general provision which codified the common law principles already recognized in [*A. C. Frost & Co.* v. *Coeur D'Alene Mines Corp.*, 312 U.S. 38 (1941)]" (A 18a), the court below completely misreads *Frost*. In that case, this Court held that an option contract to purchase treasury stock was enforceable against the corporation, notwithstanding the fact that the shares were not registered. But the Court based its decision, at least in part, on the fact that "[n]o provision of

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[5] 12 C.F.R. §221 (1972), promulgated by the Board of Governors of the Federal Reserve System pursuant to §7(a) of the Securities Exchange Act of 1934, 15 U.S.C. §78g(a) (1970).

the act declares that in the absence of registration, contracts in contemplation of or having relation to a public offering shall be void." 312 U.S. at 41. Moreover, discussing the express remedies that *are* provided by the 1933 Act, this Court also stated that "the sanctions which Congress has definitely provided in order to insure obedience to the statute . . . must be given effect." *Id.* at 42. And the Court further noted that under the common law "whether a contract shall be enforced required consideration of the broad purposes of relevant statutes and the probable effect upon this. . . . [T]he end which Congress intended to accomplish was treated as the controlling factor." *Id.* at 44-45.

We submit that the decision below is squarely contrary to *Frost*. In *Frost* there was not an express statutory provision comparable to §29(b), which applies here. Moreover, in *Frost* it was the *violator* of the statute—the corporation which had failed to register its stock—which was seeking to hold the contract unenforceable; even under the terms of §29(b) the violator of the securities laws has no defense against a breach of contract action brought by the innocent party. Allowing the violator of the statute a contract defense under such circumstances would clearly have been contrary to the remedial purposes of the statute; a ruling in the corporation's favor would have encouraged future violations of the registration provisions. In the instant case, where it is the *victim* of securities fraud who seeks to defend against the contract, precisely the opposite is true.

The Court of Appeals below also offered support for its conclusions in quoting the following *dicta* from this Court's opinion in *Mills* v. *Electric Auto-Lite*, 396 U.S. 375, 387-88 (1970):

> This language establishes that the guilty party is precluded from enforcing the contract against an unwilling innocent party, but it does not compel the conclusion that the contract is a nullity, creating no enforceable rights even in a party innocent of the violation. The lower federal courts have read §29(b), . . . as rendering the contract merely voidable at the option of the innocent party. . . . This interpretation is eminently sensible. *The interests of the victim are sufficiently protected by giving him the right to rescind; to regard the contract as void where he has not invoked that right would only create the possibility of hardships to him or others without necessarily advancing the statutory policy of disclosure.* (A 17a; emphasis added by the court below.)

As we have discussed above, it is the *opening* sentence of this paragraph which states the general rule that we contend is applicable here. The language emphasized by the court below, we believe, was intended for application only to the unusual facts there presented—an attempt by minority shareholders to void a merger contract agreed to and not challenged by the majority. *Mills* simply does not support the Court of Appeals' elimination of the contract defense plainly intended by Congress to be part of the statute.

The court below also erred in concluding that, where other remedies are available, §29(b) need not be enforced because it might permit the purchaser "an unexpected windfall the amount of which depends on the fortuitous factor of how much of a down payment has been made." (A. 19a.) First, the statute does not state that §29(b) applies only in the absence of other remedies. Second, the holding is at odds with the rule in *Janigan* v. *Taylor*, 344 F.2d 781, 785 (1st Cir. 1965), *cert. denied* 382 U.S.

879 (1965), that, "it is more appropriate to give the defrauded party the benefit even of windfalls than to let the fraudulent party keep them." Third, enforcement of §29(b) according to its terms would not, as the Court of Appeals seemed to fear, dictate that a purchaser could keep the stock without paying for it. Rather, the court would certainly have an option in the appropriate case of allowing recovery of the actual value of the stock sold, minus any profit to the defrauding seller. In *Goldman* v. *Bank of Commonwealth, supra,* the court fashioned just such a remedy; while the bank was not allowed to enforce the loan agreement because of its own violation of the Act, it was allowed to recover the amount loaned without interest.

In contrast, what has occurred in this case is a clear example of why §29(b) should be literally applied to discourage fraudulent acts by sellers. In cases such as this one, where the victimized purchaser discovers the fraud prior to completing performance under the sales contract, the violator should not be permitted automatically to enforce the terms of that contract, thereby imposing upon the purchaser the burden of proving what is in effect a "set-off".

However, under the rule announced below, and given the uncertainties inherent in litigation, the defrauding seller may still gain more than he would have had he sold the stock with full and truthful disclosure; at worst, he retains the fair market value of the stock. He has then violated the Act without risk or peril; this cannot be what Congress intended but it is precisely what happened here.

As the judgment now stands, Ryan has been forced to pay Occidental's full asking price for the stock and Occidental has been allowed to reap a substantial profit from the sale despite its fraud.[6] The allowance of such a profit is directly contrary to basic securities law policy, as recognized by this Court in *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128 (1972). In that case, brought by defrauded sellers of securities, the Court ruled that in "the situation where the defendant received more than the seller's actual loss," the defrauded seller's "damages are the amount of the defendant's profit." 406 U.S. at 155. We believe that the principle recognized in *Affiliated Ute* —that a violator of the securities laws may not be allowed to profit from its fraud—is applicable to the instant situation.

By its ruling in this case, the Court of Appeals has held in effect that Ryan acted improperly, that the innocent purchaser of stock from a seller who committed securities fraud in the sale cannot defend against the seller's suit on the sales contract, but must complete his performance and thereafter sue for damages or rescission. The effect of this ruling cannot, we submit, be reconciled with the

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[6] In footnote 9 to its opinion, the court below indicated that its ruling on §29(b) was based in part on the fact that it was not "disposed" to grant Ryan a right equivalent to the right to rescind, which was denied Ryan because of what the court described as Ryan's "dilatory action." (A 20a.) We submit that Ryan—by refusing to begin performance under the reinsurance agreement upon learning of the fraud until Occidental agreed to make recompense—as effectively invoked the right provided by §29(b) to void the contract sued upon as if it had uttered the magic incantation, "I rescind."

remedial purposes of the antifraud provisions of the securities laws.[7]

II.

By Adopting an Improper Standard and Procedure for Review, the Court Below Sanctioned a Wrongful Invasion of the Province of the Jury and Deprived Petitioner of Its Constitutional Right to a Trial by Jury.

The court below limited its review of the trial court's order setting aside the jury verdict "to ascertaining whether the decision amounts to an abuse of discretion," (A 12a) and, in concluding there had been no abuse, it relied on evidence adduced only at the second trial. In so doing, we submit, the Court of Appeals erroneously applied a much less exacting standard of review than that applied by the other Courts of Appeals under the same circumstances. The court's refusal to disturb the trial

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[7] The result reached by the Court of Appeals means that a defrauded purchaser of stock, supposedly the object of special protection by the securities laws, has *fewer* remedies available to him than would the defrauded purchaser of some other item. §2-717 of the U.C.C. provides:

> The buyer on notifying the seller of his intention to do so may deduct all or any of the damages resulting from any breach of contract from any part of the price still due under these same contracts. Gen.Stat.N.C. §25-2-717 (1965).

§2-721 of the U.C.C. provides:

> Remedies for material misrepresentation or fraud include all remedies available under this article for non-fraudulent breach. Neither rescission or a claim for rescission of the contract for sale nor rejection or return of the goods shall bar or be deemed inconsistent with a claim for damages or other remedies. Gen. Stat.N.C. §25-2-721 (1965).

court's rejection of a jury verdict that was reasonable, fully supported by the evidence, and wholly just has created a precedent that seriously jeopardizes a litigant's fundamental right to a trial by jury.

The court below completely failed to grasp the important distinction between a trial court's denial of a motion for a new trial and the grant of such a motion on the grounds that the size of the jury verdict is contrary to the weight of the evidence. However, other Courts of Appeals in recent years have recognized this vital distinction and the constitutional implications involved.

In prior cases in which trial courts have denied new trial motions or have granted new trials because of some kind of trial error—the Courts of Appeals have been reluctant to find a reversible abuse of discretion. This reluctance is understandable; a trial court ordering a new trial because of some legal error is exercising its authority as arbiter of the law, and a trial court refusing to disturb a jury's verdict is upholding the jury's function as trier of fact.

But when confronted with the grant of a new trial by a District Court because the verdict was felt contrary to the weight of the evidence or the damage award was thought excessive, as is the case here, the Courts of Appeals have enforced a much stricter standard. In such cases, the reviewing courts have held themselves duty bound to examine closely the action of the trial court in vacating findings of fact returned by the jury. Such close supervision by an appellate court is necessary "to protect the litigants' right to jury trial," since, in rejecting the jury's verdict, the "judge takes over, if he does not usurp, the prime function of the jury as the trier of the facts." *Lind* v. *Schenley*

Industries, Inc., 278 F.2d 79, 90 (3rd Cir. 1960), *cert. denied*, 364 U.S. 835 (1960). Accord, *Fireman's Fund Insurance Co.* v. *Malco Wrecking Co., Inc.*, 466 F.2d 179, 186-7 (8th Cir. 1972), *cert. denied*, 410 U.S. 930 (1973); *Grove* v. *Dun & Bradstreet, Inc.*, 438 F.2d 433, 438 (3rd Cir. 1971), *cert. denied*, 404 U.S. 898 (1971); *Duncan* v. *Duncan*, 377 F.2d 49, 52 (6th Cir. 1967), *cert. denied*, 389 U.S. 913 (1967); *Berner* v. *British Commonwealth Pacific Airlines*, 346 F.2d 532, 541 (2nd Cir. 1965), *cert. denied*, 382 U.S. 983 (1966).

These decisions by the Courts of Appeals follow the general principles expressed in the opinions of this Court regarding the sanctity of the jury's fact-finding role and the duty of the courts to "jealously guard" a litigant's right to a jury trial. *Jacob* v. *New York*, 315 U.S. 752, 753 (1942). In *Tennant* v. *Peoria & Pekin Union Ry. Co.*, 321 U.S. 29, 35 (1944), for example, this Court made clear, in its reversal of a Court of Appeals' decision setting aside a jury verdict, that a court's freedom to overturn a jury's conclusions of fact is limited indeed:

> It is the jury, not the court, which is the fact-finding body. It weighs the contradictory evidence and inferences, judges the credibility of witnesses, receives expert instructions, and draws the ultimate conclusion as to the facts. The very essence of its function is to select from among conflicting inferences and conclusions that which it considers most reasonable. [citations omitted]. That conclusion, whether it relates to negligence, causation or any other factual matter, cannot be ignored. Courts are not free to reweigh the evidence and set aside the jury verdict merely because the jury could have drawn different inferences or conclusions or because judges feel that other results are more reasonable.

Taylor v. *Washington Terminal Company*, 409 F.2d 145 (D.C. Cir. 1969), *cert. denied*, 396 U.S. 835 (1969), illustrates the principles that should have been applied below and the conflict among the circuits. In *Taylor*, the trial court found the jury's damage award of $80,000 excessive and granted the defendant's new trial motion; at the second trial, the jury awarded plaintiff only $25,000. The Court of Appeals, noting the importance of the role of the jury as fact-finder, evaluated the conflicting evidence and found that the jury could have reasonably returned a verdict for the larger amount. The court reversed and ordered the entry of judgment on the verdict returned at the first trial, holding that "where . . . it is clear that the jury has stayed within the reasonable range, the deference due its findings of fact outweighs the deference due the trial judge's first hand review of the evidence." 409 F.2d at 149.

The Sixth Circuit Court of Appeals has in two recent cases adopted and applied this same rule—that an appellate court "will . . . 'reverse the grant of a new trial for excessive verdict only where the quantum of damages found by the jury was *clearly* within "the maximum limit of a reasonable range." ' (emphasis in original)." *Manning* v. *Altec, Inc.*, 488 F.2d 127, 133 (6th Cir. 1973), quoting from *Taylor; Brewer* v. *Uniroyal, Inc.*, 1974 Trade Cas. ¶75,127, at p. 97,047 (6th Cir. 1974). *Cf. Gorsalitz* v. *Olin Mathieson Chemical Corporation*, 429 F.2d 1033, 1046-47 (5th Cir. 1970), in which the Fifth Circuit reversed a trial court's grant of remittitur because it was greater than the amount which would have reduced the damages awarded to "the maximum which the jury could reasonably find."

Not only did the court below apply an improper and conflicting standard of review on the new trial issue, it af-

firmed on the basis of its construction of testimony that was not in the record at the time of the trial court's decision but appeared only in the record of the second trial.

In conflict with this procedure, other Courts of Appeals examining the propriety of a trial court's grant of a new trial have restricted their examination of the record to what was before the trial court at the time of its decision. Thus, in *Hourstan* v. *Harrlan*, 457 F.2d 1105, 1107 (3rd Cir. 1972), the Court of Appeals for the Third Circuit, in considering on appeal from a second trial a claim that the trial court had erroneously granted a new trial on the grounds that the first trial verdict was contrary to the weight of the evidence, ruled that "only the events of that first proceeding as they related to the court's order need be evaluated." And the Court of Appeals for the Sixth Circuit, dealing with the same situation in *Duncan* v. *Duncan*, *supra*, based its decision on "the facts as developed at the first trial." 377 F.2d at 50.

Examination by this Court of what transpired in the first trial demonstrates clearly, we submit, that the Court of Appeals applied an improper standard and procedure for review. Such scrutiny is necessary because the trial court gave no explanation for its conclusion that the first trial evidence was insufficient to support the jury's damage award and the opinion of the Court of Appeals fails to provide the appropriate "detailed appraisal of the evidence bearing on damages." See *Grunenthal* v. *Long Island R. Co.*, 393 U.S. 156, 159 (1968).

At the close of the evidence in the first trial, jury instructions on the issues raised by Ryan Associates' counterclaim were given by the court as approved by both parties. After finding that Occidental had violated the antifraud provisions of the federal securities laws, the jury went on to compute damages in a way that adhered completely to the agreed-upon formula given in the court's

instructions. Assuming the evidence submitted on behalf of Ryan on damages was believed, the jury was in fact *required* by the instructions of the court to return a verdict for exactly the amount awarded.

The instructions on damages were clear:

> The measure of damages . . . is the difference between what the defendant in this case, Pat Ryan and Associates, agreed to pay for 6,000 shares of Virginia Surety Company stock, and what this Virginia Surety Company stock was worth to a willing and prudent investor, knowing all of the facts about Virginia Surety at the time it was purchased by the defendant. (Tr. I, Nov. 17, 1972, at 140-41.)

Given the District Court's subsequent instructions to the jury that it was to consider that Ryan had agreed to pay $2,297,000 for the stock of Virginia Surety, the jury's only remaining task was to determine what the stock was actually worth at the time it was sold to Ryan, and to award the difference in damages.

The testimony of expert witness James Rutherford was that, given the infirmities of the company (which had been misrepresented or concealed), the stock of Virginia Surety was worth no more than $1,500,000. (Tr. I, Nov. 16, 1972, at 54-55.) The difference between this figure and the figure that the jury was instructed to consider that Ryan Associates had agreed to pay was $797,000, precisely the amount awarded by the jury in damages.

Moreover, the jury's valuation of the Virginia Surety stock at $1,500,000 was supported by substantial other evidence in the first trial record. Occidental vice-president Robert Marshall, a former officer and director of Virginia Surety, testified that he considered $1,500,000 a "fair price." (Tr. I, Nov. 14, 1972, at 335.) Occidental chairman R. P. Woodson testified that Occidental Life had itself

purchased the stock from its subsidiary Occidental Fire & Casualty at approximately that price shortly before the sale to Ryan. (Tr. I, Nov. 15, 1972, at 22.)

In view of the explicit instructions on the measure and computation of damages and the considerable evidence supportive of the jury's action thereon, the conclusion of the District Court that the verdict on damages was "grossly contrary to the weight of the evidence" (A 26a) was, we respectfully submit, untenable and would have been reversed had the Court of Appeals applied the proper standard and procedure for review.

Furthermore, not only did the court below improperly base its affirmance of the new trial order on testimony adduced only in the second trial, but it completely misapplied that evidence.

To justify its decision, the court below stated that "[Ryan's] own experts testified that the difference in value of Virginia Surety because of the defects amounted to about $200,000," and that "[t]his amount constituted the major portion of [Ryan's] damages." (A 12a.) But the difference between the actual value of the stock of Virginia Surety and what the stock would have been worth had the company been free of defects has absolutely no relation to Ryan Associates' damages.

Ryan did not sue for the injury done to Virginia Surety by the mismanagement of the company by its former owners. Rather, Ryan Associates has sought to recover the damage it suffered as a *purchaser* by Occidental's fraudulent action in connection with the sale of stock. The correct measure of that damage is not what it would take to make Virginia Surety whole, but the difference between the price Ryan was required to pay and the actual value of the stock. *Estate Counseling Service, Inc.* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 303 F.2d 527, 533

(10th Cir. 1962); see also *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128, 155 (1972).

In many cases, of course, there would be no difference in these two measures. But here, the defrauded purchaser agreed to a purchase price far in excess of the value of the stock, in return for an arrangement (the reinsurance agreement) under which a major portion of the price could be satisfied by a transfer of business to the seller rather than with cash. The seller's preemptory suit on the contract and the trial court's directed verdict against Ryan forced the transaction into a straight cash deal at a figure far above the asking price that the buyer had at the outset rejected as excessive. As a result, the defrauded party has been left with only partial compensation for its loss and the seller has been handsomely rewarded for its fraud.[8]

In any event, the expert testimony as to "difference in value" upon which the court below has relied must be considered in context of earlier testimony by the same expert, Ralph Colton. He testified that the actual value of the stock of Virginia Surety was $1,466,000 and that the value of the charter and licenses of Virginia Surety would theoretically have been increased from $350,000 to about $560,000 to $600,000 if the company had been defect-free. (Tr. II at 771-74.) Thus, Colton's testimony can only be viewed as an expression of his opinion that the hypothetical defect-free company would have been worth $200,000

[8] This unjust second trial result was caused, we submit, by the trial court's insertion into the charge on damages, over Ryan's objection, of a description of the proper measure of damages as being equal to the "diminution in value" of the stock of Virginia Surety due to Occidental's fraud. The Court of Appeals refused to find prejudicial error in this portion of the trial court's charge.

more, or about $1.7 million; his testimony was not, as the court below erroneously observed, that "the difference [$200,000] . . . constituted the major portion of [Ryan's] damages." (A 12a.) Since Ryan was required by the directed verdict to pay not $1.7 million but $2,297,000 for the stock, the court manifestly understated Ryan's loss in the transaction.

In sum, the decision by the Court of Appeals upholding the trial court's grant of a new trial has deprived Ryan of a reasonable and proper jury verdict on the question of the amount of his damages in a way that seriously jeopardizes the constitutionally protected right to trial by jury. In order to preserve that right, this Court should grant review.

CONCLUSION

For the reasons set forth above, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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September 22, 1974

ARCHIVES

APPENDIX A

OCCIDENTAL LIFE INSURANCE COMPANY
OF NORTH CAROLINA,
Appellee,

v.

PAT RYAN & ASSOCIATES, INC.,
Appellant.

OCCIDENTAL LIFE INSURANCE COMPANY
OF NORTH CAROLINA,
Appellant,

v.

PAT RYAN & ASSOCIATES, INC.,
Appellee.

Nos. 73-2227, 73-2228.

United States Court of Appeals,
Fourth Circuit.

Argued March 5, 1974.
Decided May 8, 1974.

Before CRAVEN and WIDENER, Circuit Judges, and WARD*, District Judge.

HIRAM H. WARD, District Judge.

This is a timely appeal by Occidental Life Insurance Company of North Carolina (Occidental) and cross appeal by Pat Ryan Associates, Inc. (Associates) from judgment

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* M.D.N.C., sitting by designation.

of the district court rendered after the second trial to a jury of this matter.

The particular controversy here concerns the sale of stock to Associates by Occidental. The sale involved all of the outstanding shares of Virginia Surety Company, Inc. (Virginia Surety). Until right before the sale to Associates, Virginia Surety was owned by Occidental Fire and Casualty Company (Occidental Fire). Occidental Fire is a wholly-owned subsidiary of Occidental. Both Occidental Fire and Virginia Surety were primarily engaged in insuring long-haul trucking liability. Virginia Surety held licenses to write this insurance in forty-nine states and the District of Columbia. In the early part of 1969, it was decided to sell Virginia Surety without its agency plant and portfolio of insurance business. Virginia Surety was to be prepared so that it would have no liabilities and only have assets consisting of its charter, state licenses, and bonds on deposit with the insurance commissioners in the various states. The decision to sell was ostensibly made because Occidental Fire had by then acquired licenses in most of the states where Virginia Surety also had licenses.

Associates' interest in Virginia Surety arose because it wanted to move into other states. Since Associates was primarily engaged in writing credit life, health, accident and disability insurance in a limited number of states, it would have to amend Virginia Surety's licenses in order to use that company's licenses to expand its business to other states. Nevertheless, Associates evidently felt that it could more readily move into other states if it only needed to amend the existing licenses of Virginia Surety, than if it had to secure approval of the insurance commissioners by making an initial application.

Opinion of Court of Appeals, Fourth Circuit

On September 18, 1969, Virginia Surety was sold to Occidental, and in turn, on October 22, 1969, Occidental and Associates agreed to sales terms. Associates was to pay Occidental $1,527,000 in cash and three annual payments of $250,000 in the form of reinsurance premiums which Associates would place with Occidental, and which Occidental would immediately reinsure with other companies designated by Associates. The sale price was actually higher than Occidental was asking. The reason for this was because Associates proposed to use the reinsurance plan in order to reduce the amount of cash it would have to pay. "Since Ryan Associates was already producing this business for others in states where it was not licensed, it would cost Associates nothing more to produce this business for Occidental instead, since its expenses would remain the same." (Associates Brief, p. 16). If the reinsurance provisions were not performed, Associates was to make the payments in cash. Later, Associates also agreed to make an additional payment of $20,000 in premium income to cover finders' fees incurred by Occidental. The closing took place on October 30, 1969.

Associates failed to provide Occidental with the reinsurance payments, and Occidental filed a breach of contract action in state court. The action was removed to federal court, where Associates answered and counterclaimed for breach of warranty and fraud. Nearly two years thereafter, and only ten days before the date set for the first trial, Associates moved to amend its counterclaim in order to assert violations of federal securities laws, and included a request for rescission.[1] The district

[1] Associates claimed that Occidental violated Sections 12(2) and 17(a) of the Securities Act of 1933, 15 U.S.C. §§ 77*l*(2) & 77q(a), and Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. § 240.-10b-5.

court granted the motion at the conclusion of the evidence, but denied the request for rescission.

In regard to its counterclaim, Associates alleged that before it purchased Virginia Surety the National Association of Insurance Commissioners made an examination of Virginia Surety which showed that the capital of the company was substantially impaired. In September and early October of 1969, Occidental Fire made a contribution to make up the deficit. On October 27, 1969, Virginia Surety accepted the report of the examiners which showed that as of December 31, 1968, Virginia Surety's capital was impaired to the extent of $2,942.04 and that Occidental Fire had made a voluntary contribution to the surplus of the company. Associates claims that misrepresentations and nondisclosure of these facts caused it damage in that after the sale, the State of Connecticut revoked Virginia Surety's license based, at least in part, on the tri-annual examination report. In February, 1970, the State of Maryland followed Connecticut's lead and also revoked Virginia Surety's license, although it later converted the action to a suspension.

Associates also presented evidence of other misrepresentations or nondisclosures which purportedly affected the value and usefulness of Virginia Surety. In June of 1969 the Insurance Commissioner of North Carolina learned that Virginia Surety might be sold. He renewed the license with the understanding that if the company were sold, the new owner would have to requalify. In December 1969, Associates also learned that Virginia Surety had agreed, in October 1969, not to write any new or old renewal insurance in California or Michigan. The two states procured this consent as a condition in order that

Occidental Fire could qualify in those states. Thereafter, Associates had to borrow $500,000 to be used to increase the capitalization of Virginia Surety before the two states let that company write insurance.

In both the first and second trials the district court granted Occidental's motion for a directed verdict on its breach of contract claim in the amount of $770,000. It also denied Associates' claim of rescission. In both trials, the jury found that Occidental had violated the securities laws and in the first trial awarded damages in the amount of $797,000. The district court set that verdict aside as being grossly contrary to the weight of the evidence and shocking to the conscience of the court. It directed a new trial on all issues. At the second trial, the jury returned a verdict for Associates in the amount of $370,000.

Occidental challenges the district court's refusal to direct a verdict in its favor in regard to Associates' counterclaim, and the admission of evidence on the damage issue. Associates asks us to reinstate the first jury verdict and contests the instructions on damages in the second trial. Associates also attacks the directed verdict in favor of Occidental on its breach of contract claim, the district court's denial of rescission, and the award of interest.

I.

THE SALE OF VIRGINIA SURETY CONSTITUTED A SALE OF A "SECURITY" WITHIN THE PROVISIONS OF THE SECURITIES EXCHANGE ACT OF 1934

[1] Occidental contends that the district court erred in holding that the sale of the stock of Virginia Surety constituted a sale of a "security" as that word is used in

Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b),[2] and defined in Section 3(a)(10) of the Exchange Act, 15 U.S.C. § 78c(a)(10). It does concede that the sale included an instrument literally covered in Section 3(a)(10), which states: "The term 'security' means any note, *stock*, treasury stock, bond, ..." It claims that Section 10(b) has the purpose of protecting investors, and thus it is not sufficient to merely show a sale of an instrument literally covered by Section 3(a)(10). Instead, it is said that the transaction must contain

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[2] Section 10(b) provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> . . .
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rule 10b-5, 17 C.F.R. § 240.10b-5, promulgated pursuant to Section 10(b), provides:

> It shall be unlawful for any person directly or indirectly, by the use of any means or instrumenttality of interestate [sic] commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security.

some investment element before a sale falls within the purview of Section 10(b). With respect to the sale of Virginia Surety, Occidental contends that it sold a corporate shell including the corporate charter and licenses and deposits in the various states. It says that this alleged sale of business assets does not and should not be the subject of federal securities regulation.

[2, 3] The fact that the instruments used in this transaction involve stock and thus come within the literal definition of a "security" creates a strong presumption that the transaction is covered by Section 10(b). It is not necessary for purposes of Section 10(b) that every instrument used in a sale transaction meet the definition of an "investment contract" as Occidental seems to contend. As stated in Tcherepnin v. Knight, 389 U.S. 332, 339, 88 S.Ct. 548, 554, 19 L.Ed.2d 564, 571 (1967):

> Clearly, then, the petitioners' withdrawable capital shares have the essential attributes of investment contracts as that term is used in § 3(a)(10) and as it was defined in Howey. But we need not rest our decision on that conclusion alone. "Instruments may be included within any of [the Act's] definitions, as matter of law, if on their face they answer to the name or description." S. E. C. v. C. M. Joiner Corp., supra, [320 U.S. 344], at 351 [64 S.Ct. 120, at 123], 88 L.Ed. [88] at 93. The petitioners' shares fit well within several other descriptive terms contained in § 3(a)(10).

That case indicated that Section 3(a)(10) should be read broadly in order to fulfill the remedial purposes of the Securities Exchange Act.

Nevertheless, Occidental contends that the sale of business assets is solely a matter of state law concern, that the stock transferred in this case was a mere vehicle used to effectuate the sale of assets, and that the alleged fraud

involved the value of those assets but did not directly concern the stock. Thus it says that despite the literal coverage, the sale here was not within the spirit of Section 10(b), which it says is to protect investors in stock, and not buyers of businesses.[3]

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[3] This line of reasoning is not without some support. Thus in Lino v. City Investing Co., 487 F.2d 689 (3rd Cir. 1973) the court held that the personal promissory note given by the buyer in order to purchase franchise licensing agreements did not bring the transaction within the Securities Exchange Act's coverage, although literally the transaction would appear to be covered. The court pointed out that the definitional sections of the act, such as Section 3(a)(10), 15 U.S.C. § 78c(a)(10) contained the qualification: "unless the context otherwise requires." Using this language, the court held that the commercial context of the case before it compelled a finding of no coverage under Section 10(b). It emphasized that the notes were the personal promissory notes of a private party who was the one who claimed to be defrauded, and that the note was not for sale to the public and was not obtained for investment or speculation. It voiced concern that a contrary ruling could bring nearly every retail credit transaction under control of the federal securities laws. (It noted that other courts have reached differing conclusions on whether the purchase or sale of notes between private parties constitutes a sale of securities. See n. 11-13, at 694. It said that none of those cases, where jurisdiction was found to exist, contained all of the factors present in its case.)

None of these special circumstances appear in the instant case. Rather the sale of Virginia Surety more closely resembles an ordinary stock transaction. The stock of Virginia Surety involved stock which any member of the public could own. Occidental was ready to offer Virginia to any member of the public who would purchase it. The injury caused by the alleged fraud directly affected the value of the stock. Finally, as will be discussed later, Associates' purchase of Virginia Surety involved an investment. Without approving the decision in Lino v. City Investing Co., *supra*, those facts sufficiently distinguish this case from it so as to make that decision inapplicable to the facts here.

However, it is inescapable that the sale of Virginia Surety by Occidental was accomplished by the transfer of stock and that there was evidence of fraud in connection with the transfer. The fact that the transfer could have been accomplished in a different way has no significance. Nor does the Court find persuasive the argument that ordinary commercial transactions should be left to the protection of state laws. As stated in Supt. of Insurance v. Bankers L. & C. Co., 404 U.S. 6, 10-12, 92 S.Ct. 165, 168, 30 L.Ed.2d 128, 133-134 (1971):

> The fact that the fraud was perpetrated by an officer of Manhattan and his outside collaborators is irrelevant to our problem. For § 10(b) bans the use of any deceptive device in the "sale" of any security by "any person." And the fact that the transaction is not conducted through a securities exchange or an organized over-the-counter market is irrelevant to the coverage of § 10(b). Hooper v. Mountain States Securities Corp., [5 Cir.,] 282 F.2d 195, 201. Likewise irrelevant is the fact that the proceeds of the sale that were due the seller were misappropriated. . . . Hence we do not read § 10(b) as narrowly as the Court of Appeals; it is not "limited to preserving the integrity of the securities markets" (430 F.2d [355], at 361), though that purpose is included. Section 10(b) must be read flexibly, not technically and restrictively. *Since there was a "sale" of a security and since fraud was used "in connection with" it, there is redress under § 10(b), whatever might be available as a remedy under state law* (Emphasis added).

That case involved the sale of a corporation's Treasury bonds by an officer, who converted the proceeds. While conceding this was not the type of fraud ordinarily associated with the purchase or sale of securities, the Supreme Court

made clear that coverage under Section 10(b) should not be read restrictively.

[4-6] We need not speculate as to the result if this transaction did not involve the sale of stock, but rather a simple transfer of assets.[4] That situation is not before us. In this case Occidental sold stock which literally fits the definition of a security. The fact that Associates purchased all of the outstanding stock of Virginia Surety, rather than a small fractional share, cannot serve as a basis for granting or denying coverage under Section 10(b). Bailey v. Meister Brau, Inc., 320 F.Supp. 539 (N.D.Ill. 1970); *but see* Chiodo v. General Waterworks Corporation, 380 F.2d 860, 864 (10th Cir. 1967) (dictum). In both instances, Associates would be making an investment. In this case, Associates sought more than a corporate charter and licenses and deposits in the various states. It needed an on-going

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[4] Some courts have held that the sale of assets with a concomitant use of instruments that literally meet the definition of a "security" in Section 3(a)(10) is sufficient to predicate liability under Section 10(b). See cases cited in n. 11, Lino v. City Investing Co., *supra*, at 694. Thus in Alberto-Culver Company v. Scherk, 484 F.2d 611, 615 (7th Cir. 1973), the court held:

> This mandate [stated in Tcherepnin v. Knight, *supra*] to construe broadly the term "security" compels our conclusion that the agreement to incorporate the SEV entity, and to transfer the assets of the SEV, FLS, and Lodeva entities in exchange for cash and promissory notes involves a "security" within the meaning of the Securities Exchange Act of 1934. Movielab, Inc. v. Berkey Photo, Inc., 452 F.2d 662 (2nd Cir. 1971); Lawrence v. Securities and Exchange Comm., 398 F.2d 275 (1st Cir. 1968).

See also Vincent v. Moench, 473 F.2d 430 (10th Cir. 1973).

corporate enterprise with a good business reputation so that it could expand its business. The application of Section 10(b) cannot depend on whether the purchaser of stock buys a small interest, a controlling interest, or all of the stock, of a corporation. Such a standard would be difficult to apply and create a capricious basis for dispensing the protection of Section 10(b). The Court finds no reason for reading the Securities Exchange Act in a manner that provides coverage of the small investor, but not the large one. Such a construction would fly in the face of the remedial purposes of the Act. In one sense the large investor has a more pressing need for protection to the extent that he has expended a greater amount of his resources. It is entirely irrelevant that the parties *could* have conducted their business transaction without the use of the stock. The plain fact is that they *did* choose to use the stock. The transaction literally falls within the terms of Section 10(b), and thus Associates is entitled to the protection of that section. Supt. of Insurance v. Bankers L. & C. Co., *supra*. This transaction not only comes within the letter of the law, but within the spirit of it also. The district court properly submitted the counterclaim of Associates to the jury.

[7, 8] We further conclude that there was sufficient evidence to support the jury's verdict on Associates' counterclaim. Whatever degree of reliance is needed to prove a Section 10(b) case, see Johns Hopkins University v. Hutton, 488 F.2d 912, 914-915 (4th Cir. 1973), the evidence taken in a light most favorable to Associates, the prevailing party on the issue, amply supports the finding of the jury on Associates' counterclaim. Also, the district court did not commit prejudicial error in admitting expert testi-

mony as to Associates' damages. Occidental had ample opportunity to cross-examine Associates' experts and have them explain their testimony. The district court's instruction, as will be discussed later, set out the appropriate standard in regard to damages with which the jury could properly evaluate the expert testimony.

II.

THE DISTRICT COURT DID NOT COMMIT REVERSIBLE ERROR IN SETTING ASIDE THE VERDICT OF THE FIRST TRIAL AND GRANTING A SECOND TRIAL

[9-10] It is a well-established rule that a district court may set aside a verdict and grant a new trial based on the fact that the damage award of the jury is either excessive or inadequate. However, our review of that decision is limited to ascertaining whether the decision amounts to an abuse of discretion. Simmons v. Avisco, Local 713, Textile Workers Union, 350 F.2d 1012 (4th Cir. 1965); Rachesky v. Finklea, 329 F.2d 606 (4th Cir. 1964); and Young v. International Paper Company, 322 F.2d 820 (4th Cir. 1963). After examining the record in regard to the evidence on damages, we cannot conclude that the district court abused its discretion. Associates' own experts testified that the difference in value of Virginia Surety because of the defects amounted to about $200,000. This amount constituted the major portion of Associates' damages. Thus we cannot find the district court abused its discretion in finding that the first verdict of $797,000 was excessive.

III.

THE DISTRICT COURT CORRECTLY INSTRUCTED THE JURY ON THE ISSUE OF DAMAGES

Associates challenges the district court's instructions on damages in the second trial.[5] The basic contention is that the district court erred in placing the value of a defect-free Virginia Surety at $2,297,000, the price the parties had themselves set. Associates contends that Virginia Surety was not worth what Associates itself had determined to be the market value of Virginia Surety without defects. It sought to prove that the fair market value, without defects, was less than the contract price. Thus it claims the court should have let the jury redetermine the market value of the defect-free Virginia Surety, and that in no event should Occidental have been allowed to recover more than that amount. Associates contends that by using the supposedly inflated contract price set by the parties, Occidental will get a windfall and thereby profit by its own wrongdoing. This, Associates claims, Occidental may not do. In support of this contention, it cites the following language in Affiliat-

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[5] The court's instruction, in pertinent part, was as follows:

> The measure of damages is the difference between the price paid by the buyer on the basis of the facts known to him and the price he would have paid had he known of the misrepresentations.
>
> In other words, you must determine how much less than the agreed price, Virginia Surety was worth to the defendant had it known of the omissions and misrepresentations of the plaintiff.

This part of the charge is substantially the same as that given without objection in the first trial, and substantially the same as Associates' own requested instruction numbers 25 and 26. Associates did, however, object to the district court's instruction in the second trial.

ed Ute Citizens v. United States, 406 U.S. 128, 155, 92 S.Ct. 1456, 1473, 31 L.Ed.2d 741, 762 (1972):

> In our view, the correct measure of damages under § 28 of the Act, 15 USC § 78bb(a), is the difference between the fair value of all that the mixed-blood seller received and the fair value of what he would have received had there been no fraudulent conduct, . . ., *except for the situation where the defendant received more than the seller's actual loss. In the latter case damages are the amount of the defendant's profit.* See Janigan v. Taylor, 344 F.2d 781, 786 (CA1 1965), cert. denied, 382 U.S. 879, 86 S.Ct. 163, 15 L.Ed.2d 120 (1965). (Emphasis added).

[11] In Janigan v. Taylor, 344 F.2d 781, 786 (1st Cir. 1965), cited and relied upon by the Supreme Court as quoted above, the court appears to make the disgorgement of windfall profits theory applicable only to the case of the defrauded seller, and not a defrauded buyer like Associates.[6] However, in Zeller v. Bogue Electric Manufac-

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[6] In that case, the court set out the standard for recovery as follows:

> With respect to damages we draw a distinction between cases where, by fraud, one is caused to buy something that one would not have bought or would not have bought at that price, and where, by fraud one is induced to convey property to the fraudulent party. In the former case the damages are to be reckoned solely by "the difference between the real value of the property at the date of its sale to the plaintiffs and the price paid for it, with interest from that date, and, in addition, such outlays as were legitimately attributable to the defendant's conduct, but not damages covering 'the expected fruits of an unrealized speculation.'" [Citations omitted] On the other hand, if the property is not bought from, but sold to the fraudulent party, future accretions not foreseeable at the time of the trans-

(Footnote continued)

turing Corporation, 476 F.2d 795, 801-802 (2nd Cir. 1973) (Friendly, C. J), the court cast doubt on that rule, stating:

> The reason why the remedy has been applied for the benefit of defrauded sellers but not of buyers is not any decisive legal difference but the difficulty generally confronting the defrauded buyer in showing that the fraudulent seller has in fact reaped such a profit.

Nevertheless, even under the rule in *Zeller,* Associates has not shown, as it must, that Occidental gained a benefit from the transaction that it would not have been in the position to secure had there been no fraud. *Zeller, supra,* n. 10 at 802. Associates' real quibble is that it paid an allegedly inflated price for a defect-free Virginia Surety. That may show poor business acumen on Associates' part, but utterly fails to prove any windfall profits. The standard for damages applicable to Associates' counterclaim is the difference in the real value of Virginia Surety and the price paid. The district court so instructed.

(Footnote continued)

> fer even on the true facts, and hence speculative, are subject to another factor, viz., that they accrued to the fraudulent party. It may, as in the case at bar, be entirely speculative whether, had plaintiffs not sold, the series of fortunate occurrences would have happened in the same way, and to their same profit. However, there can be no speculation but that the defendant actually made the profit and, once it is found that he acquired the property by fraud, that the profit was the proximate consequence of the fraud, whether foreseeable or not. It is more appropriate to give the defrauded party the benefit ever of windfalls than to let the fraudulent party keep them.

IV.

THE DISTRICT COURT DID NOT ERR IN DIRECTING A VERDICT ON OCCIDENTAL'S BREACH OF CONTRACT CLAIM

Associates claims that the district court erred in directing a verdict for Occidental because Section 29(b) of the Securities Exchange Act, 15 U.S.C. § 78cc(b), precluded Occidental from maintaining its action for breach of contract due to its violation of the securities law. Section 29(b) reads in part:

> (b) *Every contract made in violation of any provision of this chapter or of any rule or regulation thereunder,* and every contract (including any contract for listing a security on an exchange) heretofore or hereafter made, the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this chapter or any rule or regulation thereunder, *shall be void* (1) as regards the rights of any person who, in violation of any such provision, rule, or regulation, shall have made or engaged in the performance of any such contract, and. . . . (Emphasis added)

We do not think Section 29(b) has such a devastating meaning. In Pearlstein v. Scudder & German, 429 F.2d 1136, 1149 (2nd Cir. 1970), Judge Friendly, in his dissent, suggests that the section

> was a legislative direction to apply common-law principles of illegal bargain, enacted at a time when it seemed much more likely than it might now that courts would fail to do this without explicit legislative instruction. . . . *There has been a conspicuous lack of judicial enthusiasm for the doctrine thus incorporated when there has been performance by the violator; the*

> *reasons are clearly set forth in Bruce's Juices, Inc.* v. *American Can Co.*, 330 U.S. 743, 752-757, 67 S.Ct. 1015, 91 L.Ed. 1219 (1947), and *Kelly* v. *Kosuga*, 358 U.S. 516, 519-521, 79 S.Ct. 429, 3 L.Ed.2d 475 (1959). (Emphasis added)

This view gains credence from the Supreme Court's opinion in Mills v. Electric Auto-Lite Co., 396 U.S. 375, 387-388, 90 S.Ct. 616, 623, 254 L.Ed.2d 593, 603-604 (1970), where it said of Section 29(b):

> This language establishes that the guilty party is precluded from enforcing the contract against an unwilling innocent party, but it does not compel the conclusion that the contract is a nullity, creating no enforceable rights even in a party innocent of the violation. The lower federal courts have read § 29(b), . . . as rendering the contract merely voidable at the option of the innocent party. . . . This interpretation is eminently sensible. *The interests of the victim are sufficiently protected by giving him the right to rescind; to regard the contract as void where he has not invoked that right would only create the possibility of hardships to him or others without necessarily advancing the statutory policy of disclosure.* (Emphasis added)

[12, 13] Thus it would appear that Section 29(b) is more properly viewed as an adjunct to the other remedies provided by the Securities Exchange Act of 1934 and that it should be read as complementing those remedies available to injured parties and not as being antagonistic. The situation here is analogous to that in A. C. Frost & Co. v. Coeur D'Alene Mines Corp., 312 U.S. 38, 61 S.Ct. 414, 85 L.Ed. 500 (1941), which involved a claim that a contract to sell

unregistered securities in violation of the Securities Act of 1933 was void and unenforceable. There the court recognized the doctrine of illegal bargains but stated:

> Here the clear legislative purpose was protection of innocent purchasers of securities. They are given definite remedies inconsistent with the idea that every contract having relation to sales of unregistered shares is absolutely void; and to accept the conclusion reached by the Supreme Court [of Idaho] below would probably seriously hinder rather than aid the real purpose of the statute. (312 U.S. at 43, 61 S.Ct. at 417, 85 L.Ed. at 505.)

While the court in *Frost* noted that the Securities Act of 1933 did not contain a provision making contracts involving unregistered securities void, that distinction does not have a determining importance. Section 29(b) itself is but a general provision which codified the common-law principles already recognized in *Frost*. Thus we feel the better view of Section 29(b) is that stated by Judge Friendly. Section 29(b) merely makes explicit that which is implicit, i.e., the recognition of the doctrine of illegal bargains in the application of the securities laws.

[14] In deciding how to fashion a remedy in the area of illegal bargains, the type and degree of illegality become highly important factors. A. L. Corbin, Corbin on Contracts, Vol. 6A, § 1534, pp. 816-20 (1962). The violation of the securities laws in this case did not involve a contract that was illegal per se. Nor did it involve a criminal act. Here the illegality involved a matter collateral to the agreement to sell stock, i.e., the misrepresentations and nondis-

closures by Occidental.[7] Moreover, Associates has an ample variety of remedies, both legal and equitable, in order to vindicate the wrong done to it and the public in general. We do not doubt that there may be some cases where public policy would call for enforcement according to the explicit terms of Section 29(b).[8] However, in this case where Associates has remedies under both the 1933 and 1934 Acts, it would not advance the purposes of the securities laws to permit Associates to obtain an unexpected windfall the amount of which depends on the fortuitous factor of how much of a down payment it has made. Such an application of Section 29(b) would serve to nullify those other remedies and substitute a penalty provision.

[15, 16] It is our view, however, that Section 29(b) should be read as being in *pari materia* with the other reme-

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[7] There has been some thought that Section 29(b) may only apply to contracts that by their own terms violate the securities laws. Naftalin & Co. v. Merrill, Lynch, Pierce, Fenner & Smith, Inc., 469 F.2d 1166, 1182, n. 25 (8th Cir. 1972). *See* A. C. Frost & Co. v. Coeur D'Alene Mines Corp., *supra*, 312 U.S. at 42, 61 S.Ct. at 417, 85 L.Ed. at 505, where the court thought it important that "the challenged contract bears no evidence of criminality and is fair upon its face. . . ." In light of our ultimate disposition, we do not reach that issue. Nevertheless, those factors may be considered in balancing the equities in deciding how to enforce the parties' rights under an illegal bargain.

[8] Serzysko v. Chase Manhatten Bank, 290 F.Supp. 74 (S.D.N.Y. 1968), aff'd per curiam, 409 F.2d 1360 (2nd Cir. 1969), and Cooper v. Union Bank, 354 F.Supp. 669 (C.D.Cal. 1973)—both cases involved the making of loans by a bank in violation of Regulation U, promulgated pursuant to Section 7 of the Securities Exchange Act of 1934, 15 U.S.C. § 78g. The banks were not permitted to recover the outstanding balance due on the loans. *But see* Goldman v. Bank of Commonwealth, 467 F.2d 439 (6th Cir. 1972), where the court considered that the equities of the situation dictated that it grant rescission thereby allowing the bank to recover the principal amount of the loan it made, but not the interest.

dies available under the securities laws, and as stated in Baumel v. Rosen, 412 F.2d 571, 576 (4th Cir. 1969), concerning Section 10(b), "[i]t must be recalled that while a defrauding party is not to be excused, neither is he to be punished." If we should treat the contract as void, Associates would stand to gain double its amount of damages. The result would hardly be equitable. Unless the public interest requires, we are reluctant to nullify a contract which has been executed, and this is especially true where the parties have other remedies at their disposal *which will produce an equitable result.*

[17, 18] Associates attempts to ameliorate the harsh result of treating the contract as void under Section 29(b) by suggesting that we could award Occidental some additional compensation. It suggests that the value of Virginia Surety be redetermined and that Occidental recover that amount rather than the contract price. In reality this approach sounds in quasi-contract where the contract is implied and recovery is determined by the reasonable value of the benefit conferred on the purchaser. The fact that we have determined that there is a valid and enforceable contract compels rejection of that theory. "There cannot be an express and an implied contract for the same thing existing at the same time." 66 Am.Jur.2d Restitution and Implied Contracts § 6 at 948 (1973). Simply stated, this case presents no basis for use of a quasi-contract theory of recovery. Associates had the option to affirm the contract and sue for damages, or it could elect to rescind.[9]

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[9] As will be discussed in the next section of this opinion, Associates by its dilatory action has lost its right to rescission. We are not disposed to grant Associates under Section 29(b) that right which it has already lost. Principles of equity, like estoppel and waiver, apply equally to actions brought under Section 29(b), as well as those brought under Section 10(b). Royal Air Properties, Inc. v. Smith, 312 F.2d 210 (9th Cir. 1962).

V.

RESCISSION

Associates claims error in the district court's denying its alternative requested relief of rescission. It asserts that the basis of its claim for rescission rested on Section 12(2) of the Securities Act of 1933 which it says provides a statutory, as opposed to an equitable, right to rescission. and thus the district court did not have discretion to bar it. Associates further claims that mere passage of time cannot preclude rescission under Section 12(2), and, in any event, Occidental's failure to raise the defenses of waiver and estoppel precludes consideration of those defenses.

[19-21] The recently reported case of Johns Hopkins University v. Hutton, *supra,* 488 F.2d 912 (4th Cir. 1973), provides a ready answer to most of Associates' contentions. Associates' reliance on Section 12(2) is misplaced. To be entitled to relief under that section, an action must be commenced "within 'one year after the discovery of the untrue statement or the omission, or after such discovery should have been made by the exercise of reasonable diligence' as required by Section 13 of the '33 Act." *Hopkins, supra,* at 914. Moreover, a party must also act with "reasonable dispatch" if he seeks rescission under Section 10(b) or under Section 17(a) of the Securities Act of 1933. *Hopkins, supra,* at 917. Since Associates had the burden of proving reasonable dispatch as an essential element for its action of rescission, Occidental was not required to plead estoppel or waiver as an affirmative defense. *Hopkins, supra,* n. 12 at 915-916.

[22] Associates was clearly aware of the problems relating to Virginia Surety by at least the early part of 1970. By the summer of 1970, Associates had held meetings with Occidental concerning these problems, and thus was chargeable with notice of the misstatements and concealments of

Occidental. Yet the first mention of rescission took place in Associates' motion to amend its answer and counterclaim in November of 1972. Associates has not met the one year rule of Section 13, nor can the passage of two and one-half years be deemed to show reasonable diligence. In Baumel v. Rosen, *supra*, the waiting of three years after the agreement and eighteen months after the party was chargeable with knowledge was held to terminate the right to rescission. The delay in this case is particularly onerous since Associates continued to run Virginia Surety as it saw fit. As stated in Baumel v. Rosen, *supra*, at 575:

> Further rationale for the requirement of immediacy is that every day's lapse renders more difficult the very aim of rescission: to return the parties to statu quo ante. That obviously is well exampled here.

The district court correctly denied Associates' request for rescission.

VI.

INTEREST AWARD

Associates challenges the award of interest. The district court awarded Occidental interest on the payments due it according to the contract on December 31 of the years 1970, 1971, and 1972. From that sum was to be deducted the interest on Associates' counterclaim award of $370,000. The interest on the counterclaim award was to run from the date of the jury's verdict which was April 28, 1973.

[23] It has been well established, at least in Section 16(b) cases involving short swing profits, that an award of prejudgment interest lies within the discretion of the trial court and such interest is not awarded as a matter of course. Gold v. Sloan, 486 F.2d 340 (4th Cir. 1973). This same rule has been held applicable to Section 10(b) cases.

Wolf v. Frank, 477 F.2d 467, 469 (5th Cir. 1973); Wessel v. Buhler, 437 F.2d 279, 284 (9th Cir. 1971).

Here the violations of the securities laws involved fraud, an element not necessary to a Section 16(b) case. Thus while an award of prejudgment interest in a Section 10(b) case is not automatic, it would seem much more likely to occur than in a Section 16(b) case. (See footnote 6 of this opinion on the measure of damages in a 10(b) case.)

[24] Considered separately, it would not be unreasonable to award Occidental prejudgment interest on its liquidated damage claim, nor to deny Associates' prejudgment interest, as done in the court below. However, when combined, it does appear to be inequitable to reward Occidental for its wrongdoing by awarding it interest on that part of the sale price which it cannot recover because of the jury verdict in favor of Associates. This is especially true when it is recalled that we refused to void the contract pursuant to Section 29(b) in order to avoid a harsh inequitable result. Thus if Occidental is to have prejudgment interest, then equity demands that Associates, the innocent party, be accorded no less. We do not think that this decision seriously departs from the district court's own view. Although it did not state the reasons for its award of interest, it is significant that it assessed the costs one half against each party. We, therefore, conclude that Associates should be awarded interest on the amount of the jury verdict from the date of the sale, which was October 30, 1969.

While we affirm the judgment of the district court, we remand the case in order that the award of interest may be amended as we have indicated.

Affirmed, as modified, and remanded.

Order Denying Petition for Rehearing

UNITED STATES COURT OF APPEALS

FOR THE FOURTH CIRCUIT

No. 73-2227

[CAPTION OMITTED]

ORDER

After careful consideration, and with the concurrence of Judge Widener and Judge Ward, the petition for rehearing is denied.

J. Braxton Craven
United States Circuit Judge

A True Copy, T e s t e:
William K. Slate, II, Clerk
By *Patricia P. Dennally*
Deputy Clerk

Order of District Court Setting Aside Verdict of Jury and Ordering New Trial on the Counterclaim
(Filed January 10, 1973)

IN THE

UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF NORTH CAROLINA
RALEIGH DIVISION

Civil No. 2603

[CAPTION OMITTED]

This case was tried to the court and a jury at the November 13, 1972 session of the court at Raleigh. Prior to the submission of the case to the jury the court directed a verdict in favor of the plaintiff on the claim set forth in plaintiff's complaint. The case was then submitted to the jury on defendant's counterclaim as set forth in an amended counterclaim which the court in its discretion allowed to be filed, and the jury answered all of the issues arising on the counterclaim in favor of the defendant and assessed damages in the amount of $797,000. The case is now before the court on plaintiff's motion for judgment notwithstanding the verdict and in the alternative for a new trial on all issues arising on the counterclaim or in any event on the issue of damages.

At the hearing on these motions defendant made an oral motion that the court reverse the verdict directed in favor of the plaintiff on its claim at the trial, and this

Order Setting Aside Verdict of Jury and Ordering New Trial on Counterclaim

motion is denied. Plaintiff's motion for judgment notwithstanding the verdict is also denied.

After fully considering the record and the able arguments of counsel the court remains of the opinion that the answers of the jury to the issues on defendant's counterclaim, at least with respect to the issue of damages, was so grossly contrary to the weight of the evidence as to be shocking to the conscience of the court. Accordingly, the court in the exercise of its discretion must set aside the verdict on the issue of damages. The court is also of the opinion that in view of the circumstances surrounding the filing of the defendant's amended answer and counterclaim that justice requires that a new trial be had on all of the issues arising on defendant's amended counterclaim. It is thereupon

ORDERED that the verdict of the jury rendered in this action on November 17, 1972 be and the same is hereby set aside and that a new trial be had on all the issues arising on defendant's amended counterclaim.

The plaintiff has filed a motion to strike certain portions of defendant's amended answer and counterclaim, and the court's ruling on this motion will be the subject of a separate order.

The case will be set down for re-trial at the civil session of this court beginning on February 19, 1973.

F. T. DUPREE, JR.
United States District Judge

January 8, 1973.

Order Setting Aside Directed Verdict in Favor of Plaintiff, Directing That Case Be Re-Tried to a Jury, and Denying Defendant's 54(b) Motion
(Filed March 8, 1973)

IN THE

UNITED STATES DISTRICT COURT

FOR THE EASTERN DISTRICT OF NORTH CAROLINA

RALEIGH DIVISION

Civil No. 2603

[CAPTION OMITTED]

Following the close of the evidence at the end of the trial of this action held in November, 1972, plaintiff's motion for a directed verdict on its claim was allowed. The case was thereupon submitted to the jury on the defendant's counterclaim upon issues and instructions as to which there was no objection by either party.

Thereafter at a hearing held for the purpose of ruling on plaintiff's motion to set aside the verdict rendered by the jury on defendant's counterclaim and following the court's intimation that the motion would be allowed defendant for the first time lodged an oral motion to set aside the directed verdict entered as to plaintiff's claim at the trial. The court was initially of the opinion that defendant's motion was without merit, but upon further consideration in the light of briefs subsequently submitted in connection with defendant's Rule 54(b) motion the court is now of opinion that the directed verdict entered at the

Order Setting Aside Directed Verdict in Favor of Plaintiff, Directing That Case Be Re-Tried to a Jury, and Denying Defendant's 54(b) Motion

trial on plaintiff's claim as well as the verdict in favor of defendant on its counterclaim should be set aside and that the case should be re-tried on all issues raised by the complaint, answer and counterclaim.

Accordingly, it is now

ORDERED:

1. That the directed verdict in favor of plaintiff on plaintiff's claim be and the same is hereby set aside;

2. That the case be re-tried to a jury at the March 19, 1973 special session of this court as presently scheduled; and

3. That in view of the foregoing rulings that the defendant's Rule 54(b) motion be and the same is hereby denied.

This order is entered without prejudice to the right of the plaintiff to renew its motion for a directed verdict upon the re-trial of the case and to have the motion heard and re-determined at that time in the light of the record as it may then exist and the applicable law.

F. T. DUPREE, JR.
United States District Judge

March 7, 1973.

Order Denying Post-Trial Motions
(Filed June 19, 1973)

IN THE

UNITED STATES DISTRICT COURT

FOR THE EASTERN DISTRICT OF NORTH CAROLINA
RALEIGH DIVISION

Civil No. 2603

[CAPTION OMITTED]

At the trial of this action at the November 13, 1972 session of the court at Raleigh the court directed a verdict in favor of the plaintiff on the claims set forth in plaintiff's complaint and the jury returned a verdict in favor of the defendant on its counterclaim assessing damages in the amount of $797,000. This verdict was considered so grossly contrary to the weight of the evidence as to be shocking to the conscience of the court, and accordingly it was set aside and a new trial was ordered.

At a second trial of the case before a jury at the April 23, 1973 session of the court at Raleigh a verdict was again directed in favor of the plaintiff on its claim in the total amount of $770,000, and again the jury determined the issues raised by defendant's counterclaim in favor of the defendant but assessed defendant's damages in the amount of $370,000.

Order Denying Post-Trial Motions

The case is now before the court on the motion of plaintiff for judgment notwithstanding the verdict on the counterclaim and in the alternative for a reduction in the amount of damages recoverable by defendant on the counterclaim to $200,000, and the motions of defendant (1) to reinstate the original jury verdict on the counterclaim; (2) to set aside the directed verdict in favor of the plaintiff on its claim; and (3) in the alternative, for a new trial.

In support of its motion for judgment n.o.v. on the counterclaim plaintiff takes the position that the case is not properly cognizable under the securities laws of the United States for that those laws do not contemplate a transaction whereby a corporation transfers all of its assets to a purchaser, as was the case here, and the transfer is effected by delivery of all of the stock of the corporation rather than by a bill of sale of the corporate assets. In the absence of definite authority to the contrary this court would be inclined to agree, for it has grave reservations that the Congress intended that transactions of the kind here involved would be subject to the securities legislation. However, the courts seemed to have construed these laws to cover such transactions. *Matheson* v. *Armbrust*, 284 F.2d 670 (9th Cir. 1960): *Bailey* v. *Meister Brau*, 320 F.Supp. 539 (N.D.Ill. 1970). Plaintiff in its motion and memorandum in support thereof has cited no authority to the contrary. This motion of the plaintiff is overruled.

Two juries have found that the plaintiff through its officers, agents or employees falsely represented material facts or omitted to disclose material facts to the defendant in connection with the sale by plaintiff to defendant of the stock of Virginia Surety Company and that defendant reasonably relied on such misrepresentations or omissions.

The court is of opinion that there was ample evidence to support these findings, and they will not be disturbed. The court agrees with the plaintiff that defendant's evidence failed to establish convincingly that defendant's damages exceeded the sum of $200,000, and the court is under the impression that the jury probably arrived at its verdict by awarding the defendant the difference between the amount which plaintiff had agreed to accept in cash for the stock and the increased amount which defendant agreed to pay by employing the scheme which he devised whereby plaintiff would obtain the benefit of certain reinsurance premiums totalling $750,000 (augmented by some side transaction by $20,000 making a total of $770,000, the amount sued for by plaintiff). This difference was $370,000, the amount of the jury's verdict. The court is unable to say, however, that the jury's finding was wholly without evidentiary support or that it is so grossly excessive as to be shocking to the court's conscience. Aside from the doubtful authority of the court to reduce a verdict without consent of the parties, the court declines to set aside the verdict on the issue of damages awarded defendant on its counterclaim.

Defendant's motions to reinstate the original jury verdict on the counterclaim, to set aside the directed verdict on plaintiff's claim and for a new trial are denied.

Judgment will therefore be entered on the verdict as rendered.

F. T. Dupree, Jr.
United States District Judge

June 18, 1973.

Judgment
(Filed June 19, 1973)

IN THE

UNITED STATES DISTRICT COURT

FOR THE EASTERN DISTRICT OF NORTH CAROLINA
RALEIGH DIVISION

Civil No. 2603

[CAPTION OMITTED]

This action having been tried to a jury and verdict having been directed in favor of plaintiff on its original claim in the amount of $770,000 and the jury having returned a verdict in favor of the defendant on its counterclaim in the amount of $370,000, it is adjudged that the plaintiff is entitled to recover of defendant the difference between the two figures and accordingly it is now

ORDERED, ADJUDGED AND DECREED that the plaintiff have and recover of the defendant the sum of Four Hundred Thousand and No/100ths ($400,000.00) Dollars together with interest thereon from the date of the filing of this action and that the costs of the action be assessed one-half to plaintiff and one-half to defendant.

F. T. DUPREE, JR.
United States District Judge

June 18, 1973.

Amended Judgment
(Filed August 14, 1973)

IN THE

UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF NORTH CAROLINA
RALEIGH DIVISION

Civil No. 2603

OCCIDENTAL LIFE INSURANCE COMPANY
OF NORTH CAROLINA,

Plaintiff,

vs.

PAT RYAN & ASSOCIATES, INC.,

Defendant.

Following the entry of judgment on the jury's verdict in this action on June 18, 1973, which allowed interest to the plaintiff on the net amount found by the jury to be due the plaintiff from the date of the institution of the action the defendant filed a motion pursuant to Rule 59(e) of the Federal Rules of Civil Procedure to alter or amend the judgment with respect to the award of interest. The questions raised by the motion have been fully briefed by the parties and have been submitted to the court for decision without further argument. The court is of opinion that defendant's motion should be allowed in part and denied in part, and accordingly the judgment dated 18 June 1973 is withdrawn and the following shall constitute the judgment of the court:

Amended Judgment

This action having been tried to a jury and verdict having been directed in favor of the plaintiff on its original claim in the amount of $770,000 and the jury having returned a verdict in favor of the defendant on its counterclaim in the amount of $370,000, it is adjudged that the plaintiff is entitled to recover of defendant the difference between the two figures with interest as set out below, and accordingly it is now

ORDERED, ADJUDGED AND DECREED that the plaintiff have and recover of the defendant the sum of Four Hundred Thousand and No/100ths ($400,000.00) Dollars together with interest on the sum of $250,000 from December 31, 1970, on the sum of $250,000 from December 31, 1971, and the sum of $270,000 from December 31, 1972, less the interest on $370,000 from the date of the jury's verdict, that is, 28 April 1973; and that the costs of the action be assessed one-half to the plaintiff and one-half to the defendant.

F. T. DUPREE, JR.
United States District Judge

August 14, 1973.

Amended Judgment on Remand
(Filed August 23, 1974)

IN THE
UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF NORTH CAROLINA
RALEIGH DIVISION

Civil No. 2603

OCCIDENTAL LIFE INSURANCE COMPANY
OF NORTH CAROLINA,

Plaintiff,

vs.

PAT RYAN & ASSOCIATES, INC.,

Defendant.

Following the entry of the amended judgment in this action on August 14, 1973, plaintiff appealed and defendant cross appealed to the United States Court of Appeals for the Fourth Circuit. The Court of Appeals affirmed the judgment of this court, with the exception of this court's decision as to the date from which interest upon the award to the defendant on its counterclaim should run. It was the opinion of the Court of Appeals that defendant should be awarded interest from the data of sale, rather than from the date of the jury's verdict. The case having been remanded so that the judgment might be amended consistent with the opinion of the Court of Appeals, the amended judgment dated August 14, 1973 is withdrawn and the following shall constitute the judgment of the court:

This action having been tried to a jury and verdict having been directed in favor of the plaintiff on its original claim in the amount of $170,000 and the jury having returned a verdict in favor of the defendant

on its counterclaim in the amount of $370,000, it is adjudged that the plaintiff is entitled to recover of defendant the difference between the two figures with interest as set out below, and accordingly it is now

ORDERED, ADJUDGED AND DECREED that the plaintiff have and recover of the defendant the sum of Four Hundred Thousand and No/100ths ($400,000.00) Dollars together with interest on the sum of $250,000 from December 31, 1970, on the sum of $250,000 from December 31, 1971, and the sum of $270,000 from December 31, 1972, less the interest on $370,000 from the date of sale, that is, October 30, 1969; and that the costs of the action be assessed one-half to the plaintiff and one-half to the defendant.

/s/ *F. T. Dupree, Jr.*
F. T. Dupree, Jr.
United States District Judge

August 23, 1974

A True Copy, Teste:
John R. Whitty, Clerk
By *Joyce W. Todd*
Deputy Clerk

APPENDIX B

U.S. Const. amend. VII.

> In suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by a jury, shall be otherwise reexamined in any Court of the United States, than according to the rules of the common law.

Statutes

15 U.S.C. §78j(b) (1970)

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange . . .

> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. §78cc(b) (1970)

> (b) Every contract made in violation of any provision of this chapter or of any rule or regulation thereunder, and every contract (including any contract for listing a security on an exchange) heretofore or hereafter made, the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this chapter or any rule or regulation thereunder, shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, or regulation, shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contract, shall have acquired any right thereunder with actual knowledge

of the facts by reason of which the making or performance of such contract was in violation of any such provision, rule, or regulation: *Provided*, (A) That no contract shall be void by reason of this subsection because of any violation of any rule or regulation prescribed pursuant to paragraph (2) or (3) of subsection (c) of section 78o of this title, and (B) that no contract shall be deemed to be void by reason of this subsection in any action maintained in reliance upon this subsection, by any person to or for whom any broker or dealer sells, or from or for whom any broker or dealer purchases, a security in violation of any rule or regulation prescribed pursuant to paragraph (1) of subsection (c) of section 78o of this title, unless such action is brought within one year after the discovery that such sale or purchase involves such violation and within three years after such violation.

17 C.F.R. 240.10b-5 (1973)

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange

(1) To employ any device, scheme or artifice to defraud,

(2) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

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No. 74-339

IN THE

Supreme Court of the United States

October Term, 1974

PAT RYAN & ASSOCIATES, INC.,

Petitioner,

vs.

OCCIDENTAL LIFE INSURANCE COMPANY OF NORTH CAROLINA,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF OF RESPONDENT IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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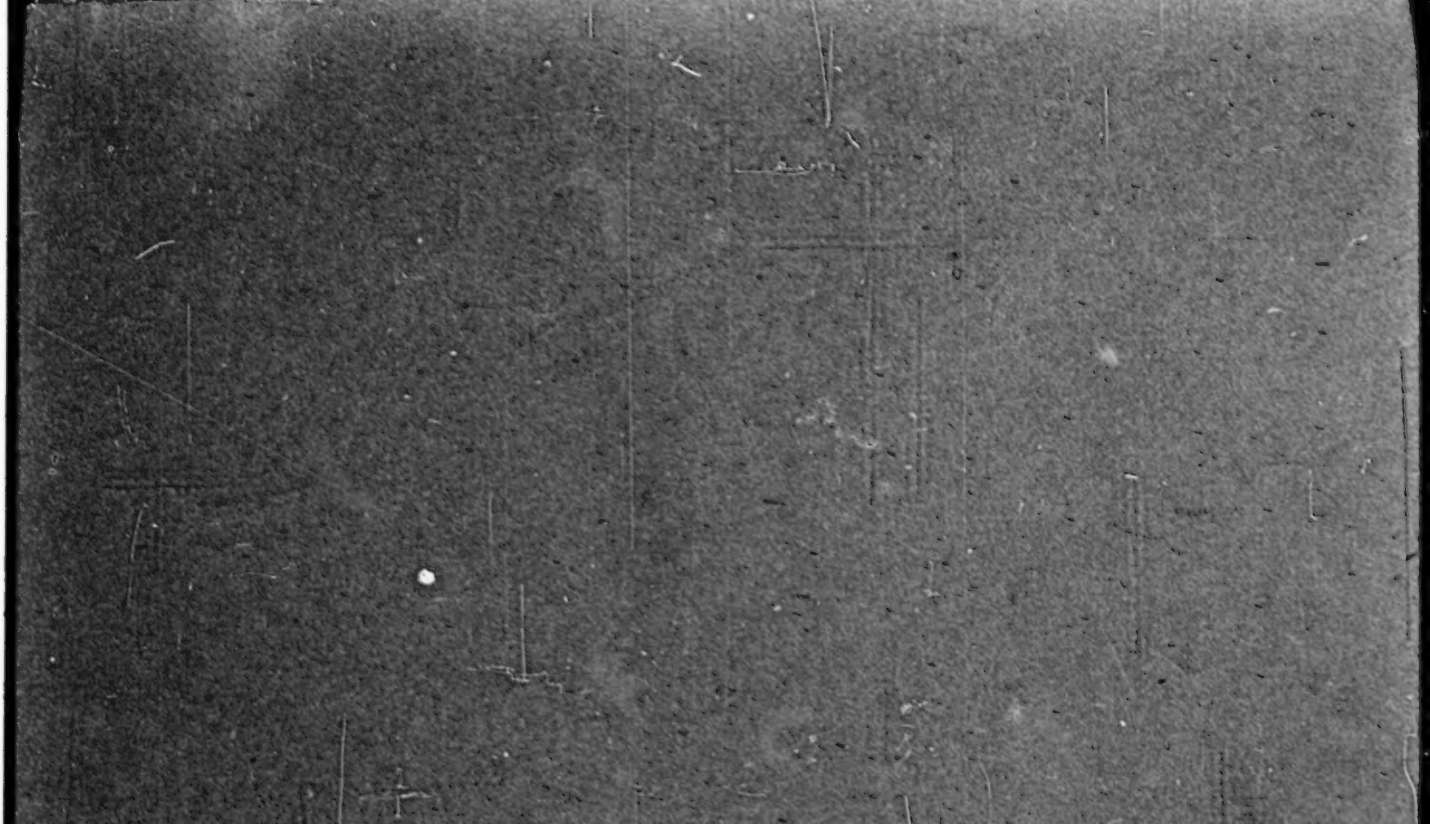

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IN THE

Supreme Court of the United States

October Term, 1974

No. 74-329

PAT RYAN & ASSOCIATES, INC.,
Petitioner,

vs.

OCCIDENTAL LIFE INSURANCE COMPANY
OF NORTH CAROLINA,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF OF RESPONDENT IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

Respondent files this brief in opposition to a Petition for a Writ of Certiorari to review the judgment of the Court of Appeals for the Fourth Circuit, entered in this case on May 8, 1974. Rehearing was denied on June 24, 1974.

OPINIONS BELOW

The opinion of the Court of Appeals is officially reported at 496 F.2d 1255, and is printed at Pages 1a through 23a of Appendix A to the Petition. Appendix A to the Petition also includes the opinions of the District Court that accompany those of its orders that are pertinent to the Petition.

JURISDICTION

Respondent does not question the statement of jurisdiction as set forth in the Petition.

QUESTIONS PRESENTED

1. Whether the court below correctly held that a seller of securities found to have violated Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder may recover the unpaid purchase price where the buyer has retained the securities, waived rescission and has been fully compensated for damages causally related to the violation.

2. Whether the court below properly determined that the trial court did not abuse its discretion in setting aside a jury verdict as excessive where the jury did not follow the court's instructions and awarded damages that bore no rational relationship to the defendant's losses.

STATUTES AND REGULATION INVOLVED

In addition to the statutes and regulation printed in Appendix B to the Petition, the statutory provision involved is Section 28(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78bb(a) (1970). Section 28(a) provides in relevant part that

> ". . . no person permitted to maintain a suit for damages under the provisions of this chapter shall recover, through satisfaction of judgment in one or more actions, a total amount in excess of his actual damages on account of the act complained of."

COUNTER-STATEMENT OF THE CASE

The Trial in this Case

Petitioner, Pat Ryan & Associates, Inc. ("Associates") seeks certiorari for a decision of the Court of Appeals for the

Fourth Circuit which refused to interfere with the discretion of the trial court in setting aside a jury verdict awarding damages in the amount of $797,000 and affirmed a judgment in the second trial awarding damages in the amount of $370,000. The verdict was rendered on a counterclaim in an action for breach of contract originally instituted against Petitioner in the state courts of North Carolina by Respondent, Occidental Life Insurance Company of North Carolina ("Occidental"). The action arose out of Petitioner's repudiation of an agreement to pay a balance owing of $770,000 for its purchase of Occidental's wholly-owned subsidiary, Virginia Surety Company, Inc. ("Virginia Surety").

Associate's counterclaim, filed after removal of the suit to federal court, initially alleged only claims of breach of warranty and common law fraud (Ans. and Counterclaim at 4-9, R. at 24).* But on November 3, 1972, nearly two years after it had filed its counterclaim, and only ten days prior to the date set for the trial, Associates moved for leave to amend its counterclaim. The amended counterclaim for the first time sought rescission and alleged that Occidental had violated Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1970) ("Exchange Act") and Rule 10b-5 thereunder, 17 C.F.R. 240.10b-5, in connection with the sale of Virginia Surety.

The court below initially denied Associates leave to amend, but at the conclusion of the evidence submitted th amended counterclaim to the jury. That jury returned a verdict in favor of Associates and awarded damages in the amount of $797,000. The court, however, set aside the verdict, finding that "at least

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*Citations to the record below will appear as "Complaint [*e.g.*] at , R. at ." "R" refers to the page number at which the item is to be found in the Record on Appeal, as cited in the Index of Record on Appeal. Citations to the reporter's transcript of the first trial will appear as "Tr. I, 11/17/72 [*e.g.*] at ." (Reference to dates in the first transcript are necessary because each day's transcript of that trial is separately paginated). Citations to the reporter's transcript of the second trial will appear as "Tr. II at ." Citations to the Petition for a Writ of Certiorari will appear as "Pet. at " and citations to the Appendix included therein as "Pet. App. at ."

with respect to the issue of damages, [it] was so grossly contrary to the weight of the evidence as to be shocking to the conscience of the court." (Pet. App. at 26a). The court also found that "in view of the circumstances surrounding the filing of [Associates'] amended answer and counterclaim . . . justice requires that a new trial be had on all of the issues arising" on the counterclaim. (*Id.*). Accordingly, the court also set aside a verdict it had directed on Occidental's breach of co tract claim.

A second trial before a jury commenced on April 23, 1973, nearly three years after Occidental filed its original lawsuit. At the conclusion of the evidence in the second trial, the court again directed a verdict in favor of Occidental on its breach of contract claim. The jury entered a verdict in favor of Associates on its counterclaim, and awarded damages in the amount of $370,000.

The trial court found even in the second trial ". . . that . . . [the] evidence failed to establish convincingly that [Associates'] . . . damages exceeded the sum of $200,000." (Pet. App. at 31a). It nevertheless was "unable to say . . . that the jury's finding was wholly without evidentiary support or that it is so grossly excessive as to be shocking to the court's conscience." (*Id.*). It therefore denied Occidental's motion to set aside the jury's verdict.

The Sale of Virginia Surety

Virginia Surety was engaged in the business of writing long-haul trucking insurance. At the time of sale the company was licensed to conduct an insurance business in 49 of the 50 states and the District of Columbia. Pursuant to agreements between the parties dated October 22, 1969, Virginia Surety was sold to Associates as a "shell' corporation, without liabilities and without its agency plant or book of insurance business. The parties agreed that the only assets of Virginia Surety at the time of sale were to be its corporate charter, its insurance licenses in 50 jurisdictions, and its capital and surplus. The capital and surplus consisted of bonds on deposit with state insurance departments, which the parties expressly valued in the October 22 agreements at $1,326,717.70.

The sale was closed on October 30, 1969. At that time Associates took possession and control of Virginia Surety and has operated the company as its own continuously thereafter.

The agreements for the sale of Virginia Surety provided for a total consideration of $2,297,000. The agreements provided that Associates would pay Occidental $1,527,000 in cash on the closing date. Associates also agreed, as additional consideration for Virginia Surety, to furnish Occidental with a minimum of $770,000 over a period of three years in reinsurance premiums from insurance to be placed with Occidental and immediately reinsured by Occidental with other companies designated by Associates. Moreover, Associates specifically guaranteed that if, for any reason, it did not perform under the reinsurance agreement, it would pay Occidental $770,000 in cash over the three year period.

The October 22 agreements contained no representations or warranties with respect to Virginia Surety's licenses. Transfers of insurance companies and the licenses held by them are not routine. "[A]s is customary, States are always very concerned about who the buyers of the company are going to be and they will take various tacks to have an opportunity to approve the buyers." (Tr. II at 258). Moreover, since Associates proposed that it use Virginia Surety's licenses to write credit life, accident, health and liability insurance, lines of insurance which Virginia Surety was not authorized to write, Virginia Surety would be required to amend its licenses under the laws of various states. (Tr. II at 1267). It was for this reason that Associates was advised during the course of negotiations that Occidental would not warrant the status of the licenses held by Virginia Surety. "It is the sort of thing that you can't warrant, how a State is going to receive a new buyer . . . [A] company might want to change the purposes of it . . . , the backing of the company might be different, and a license could be cancelled, and these are things over which we would have no control." (Tr. II at 312).

After the closing of the October 22 agreements and the transfer to Associates of Virginia Surety, Associates failed to generate for Occidental any reinsurance premiums whatsoever

and refused to make any cash payment under its guarantee. (Tr. II at 161, 180). Accordingly, Occidental commenced this action on July 21, 1970, because "[t]here had been nothing put in the pipeline to pay us and it became increasingly apparent . . . that the fellow had no intention to pay us." (Tr. II at 330).

Associates' Counterclaim

Petitioner alleged in its amended counterclaim that Respondent's failure to disclose certain material facts violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. Petitioner claimed that these facts caused Virginia Surety's license to be revoked in Connecticut and Maryland, as well as "licensing difficulties" in other states and damage to both the reputation of Virginia Surety and Associates. (App. at 14a-15a).

At trial, Petitioner's proof of license revocation or "difficulties" was limited to five states, Connecticut, Maryland, California, Michigan and North Carolina. Petitioner introduced no evidence whatsoever as to any licensing difficulties in the 45 other jurisdictions in which Virginia Surety was licensed to conduct its business. Petitioner also made no claim of any fraud or damage relating to Virginia Surety's bond portfolio, which had an agreed value of approximately $1.3 million. Nevertheless, Petitioner sought, because of "difficulties" with respect to five out of Virginia Surety's 50 licenses, to be relieved entirely of its obligation to pay the $770,000 unpaid balance on its contractual obligation and to collect additional damages.

The non-disclosure of material facts of which Petitioner complained relates to:

a. A tri-annual examination report into the condition of Virginia Surety by the National Association of Insurance Commissioners ("NAIC");

b. Understandings reached with the state insurance departments of California and Michigan under which Virginia Surety agreed not to transact new or renewal business in those states without prior approval of those departments; and

c. The renewal of Virginia Surety's license in North Carolina conditioned on the prior approval of the state Insurance Commissioner for the writing of new business.

The Tri-Annual Examination

The NAIC Report, dated October 1969, indicated that as of December 31, 1968, the capital of Virginia Surety was "impaired to the extent of $2,942.04." The report, however, also made clear that on September 17, 1969, Occidental Fire had made a $400,000 "voluntary contribution to the surplus of the company."

The capital impairment occurred when the NAIC examiners, eight months after the end of the period for which they were examining, increased Virginia Surety's loss reserves and loss adjustment expense reserves. As one of Associates' expert witnesses, former California Insurance Commissioner Richards D. Barger, testified, the reserves for claims established by a casualty company are "a guesstimate, hopefully a correct one" made by the company as to its potential future liability. (Tr. II at 838). The examiners, in the words of Mr. Barger, have "20-20 hindsight" in reviewing actual claims experience against the reserves and thus "perhaps have the advantage over the person who made the decision at the time when the figure was a piece of paper." (Tr. II at 871). Former Commissioner Barger was careful to point out that such an adjustment "doesn't denote any dishonesty or venality on the part of management." (*Id.*)

Associates nevertheless alleged that the NAIC Report caused the States of Connecticut and Maryland to revoke Virginia Surety's licenses (Amended Ans. and Counterclaim at 7, R. at 275). Virginia Surety did in fact lose its license in Connecticut after the sale to Associates. Connecticut's revocation of Virginia Surety's license triggered action by the State of Maryland, which revoked Virginia Surety's license in the latter part of February, 1970. However, that revocation was converted to a suspension almost immediately thereafter, in early March, 1970. (Tr. II at 934-35).

Patrick Ryan, Associates' President, admitted that he was informed by Occidental's management during negotiations for the sale of Virginia Surety of the company's difficulties in Connecticut. They "warned me, advised me, that Connecticut was very difficult to get along with, that they, to quote, nit-picked companies. . . ." (Tr. II at 964). He was told on more than three different occasions: "In all likelihood, you," meaning Virginia Surety, "will lose the Connecticut license." (Tr. II at 533, 218). Ryan replied to these warnings by words to the effect that "the Connecticut license was not that important to him because his business activity wasn't heavy in Connecticut." (Tr. II at 308).

The action of Maryland, on the other hand, was wholly unanticipated, and a "surprise" not only to Associates, but to Occidental as well. (Tr. II at 200). As former New York State Commissioner Bohlinger testified, there could have been no reason to "believe that a state would normally, the impairment having been corrected, just revoke a license out of hand based on that report." (Tr. II at 1261). Indeed, as Mr. Bohlinger testified, the fact that a capital impairment had occurred would *not* necessarily make it "very difficult" for a company to obtain even a new license. (Tr. II at 1276).

The California and Michigan Agreements

In preparation for the sale of Virginia Surety as a "shell" corporation, Occidental agreed with the insurance departments of California and Michigan that Virginia Surety would not transact new or renewal business in those states without prior approval of the respective state insurance commissioners. These agreements were required in order to obtain approval for the transfer of Virginia Surety's "book" of insurance business to another subsidiary of Occidental. This transfer was contemplated and fully understood by the parties. The agreements to obtain prior approval before the new owners of Virginia Surety could write insurance reflect customary regulatory concerns. "[A]s is customary, states are always very concerned about who

the buyers of the company are going to be and they will take various tacks to have an opportunity to approve the buyers." (Tr. II at 258).

Ryan (Tr. II at 422-23, 1096) admitted he was advised by Occidental's management, and that he otherwise knew, that it was "important to go quickly and introduce" himself to the state insurance commissioners in the states where Virginia Surety was licensed. (Tr. II at 1092-93). As Mr. Rutherford, one of Associates' expert witnesses, testified, many commissioners reserve the right to pass upon a new owner before that new owner is given an unrestricted right to do business in that state. (Tr. II at 698, 700). "Certainly" it is "important," Mr. Rutherford believed, for a new owner to establish a relationship with the insurance commissioner. (Tr. II at 695).

Associates, however, did not proceed quickly to contact the state insurance departments after the acquisition. As Ryan himself admitted, he did not contact the Michigan Department until February 1970, because he "was very busy." (Tr. II at 1083). Within three or four months thereafter, Virginia Surety was permitted to write credit life health insurance in Michigan. (Tr. II at 1084). Similarly, in March or April, Virginia Surety received its license to write such business in California. (Tr. II at 1086).

The North Carolina Condition

The Commissioner of Insurance of North Carolina became aware in June 1969, just prior to the annual renewal date of Virginia Surety's license, that the company might be sold. Accordingly, he forwarded Virginia Surety's renewal license under a letter making it clear that the renewal license was not to be construed as authority for Virginia Surety to continue in the insurance business in North Carolina after the sale.

Virginia Surety's license in North Carolina has never been revoked or suspended, and it has been renewed annually since the acquisition by Associates. It is "precisely" in the same condition as when Virginia Surety was owned by Occidental. (Tr. II at 1223). Virginia Surety cannot, however, write credit, health and accident insurance in North Carolina because additional

capital is required before a company can "write additional insurance." That fact was not in any way related to the tri-annual examination report. (Tr. II at 1224).

The Evidence of Damages

At the first trial, Petitioner did not introduce any evidence of damages causally related to Occidental's alleged fraud. Instead, Associates relied exclusively on appraisal testimony of an expert witness as to the "fair market value" of Virginia Surety at the time of sale. That testimony, admitted over Occidental's objections, valued Virginia Surety at $1,500,000.

During the second trial, appraisal testimony of another expert witness for Petitioner was admitted into evidence. That witness valued Virginia Surety as of the date of sale at $1,466,000. On cross-examination, however, the witness made clear that this valuation represented his own appraisal of Virginia Surety's worth, without regard to the value placed on Virginia Surety by the parties. The witness admitted that, based on the contract price, his appraisal of the damages causally related to Occidental's alleged fraud, amounted to only $200,000. (Tr. II at 815).

At the second trial, Associates also offered other proof of damages as an alternative to expert appraisal testimony. That evidence showed that the licensing difficulties allegedly caused by Occidental's fraud caused Associates to incur not more than $245,000 in expenses and loss of profits. The major item related to a loss of profits amounting to $170,000, because of fees or commissions paid to other insurance companies. These companies wrote business produced by Associates in Michigan and Maryland and then ceded that insurance to Virginia Surety —a practice known in the insurance industry as "fronting." (Tr. II at 1017, 1020). As Associates' own expert witness, former California Commissioner Barger, testified, "fronting" is "illegal" in most states. (Tr. II at 858).

The Decision of the Court Below

Upon appeal, the court below held that the trial court did not abuse its discretion in setting aside the jury verdict in the

first trial. It also ruled that Petitioner had waived any right of rescission it may have had by reason of its continued possession of Virginia Surety since the date of sale, that Petitioner could not obtain the same remedy of rescission under the contract voiding provisions of Section 29(b) of the Exchange Act, and that the trial court properly instructed the jury on the issue of damages in the second trial. The court, however, modified the judgment of the trial court by awarding Associates interest on its counterclaim from the date of sale. The effect of that modification was to substantially cancel the interest awarded by the trial court on Occidental's breach of contract judgment.

REASONS FOR DENYING THE WRIT

I.

The Court Below Properly Held That Section 29(b) of the Exchange Act Does Not Permit Petitioner, Having Retained Virginia Surety and Having Been Fully Compensated for Damages Causally Related to Occidental's Violation, to Repudiate Its Contractual Obligation.

Associates asserts that Section 29(b) of the Exchange Act renders "void" all contracts "made in violation of" Rule 10b-5 and that, regardless of Associates "actual damages," it absolutely bars Occidental's enforcement of the contract for the sale of Virginia Surety. The court below concluded, however, that Section 29(b) does not have the "devastating meaning" urged by Associates. (Pet. App. at 16a). In reaching this conclusion the court below relied upon this Court's decisions in *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375 (1970) and *A. C. Frost & Co.* v. *Coeur D'Alene Mines Corp.*, 312 U.S. 38 (1941).

In *Mills*, this Court said that Section 29(b) "does not compel the conclusion that the contract is a nullity, creating no enforceable rights. . . ." (*Id.* at 387). This Court strongly endorsed as "eminently sensible" the holdings of lower courts which, like the holding of the court below, concluded that Section 29(b) "is more properly viewed as an adjunct to the other remedies pro-

vided by the Securities Exchange Act of 1934, and that it should be read as complementing those remedies available to injured parties and not as being antagonistic." (Pet. App. at 17a).

These lower court holdings uniformly reject Associates' contention that Section 29(b) automatically makes a contract unenforceable irrespective of equitable considerations. A contract subject to Section 29(b) "cannot possibly be considered absolute and totally void. It is a contract 'voidable' at the option of the innocent party . . . having the right of recision [sic]." *Greater Iowa Corp.* v. *McLendon*, 378 F.2d 783, 792 (8th Cir. 1967). The innocent party's remedies under Section 29(b) are enforceable in "a proceeding in equity." *Spoon* v. *Walston & Co.*, 345 F. Supp. 518 (E.D. Mich. 1972).

Thus, in *Royal Air Properties, Inc.* v. *Smith*, 312 F.2d 210 (1962), the Court of Appeals for the Ninth Circuit made clear that Section 29(b) does not furnish immunity from the normal defenses of waiver and estoppel so as to permit a buyer of securities to retain the benefits of the seller's performance while repudiating his own performance. The court referred to its earlier decision in *Straley* v. *Universal Uranium & Milling Corp.*, 289 F.2d 370 (9th Cir. 1961), where it said with respect to an action under Section 12(1) of the Securities Act of 1933, 15 U.S.C. § 771(1) (1970), that estoppel and waiver

> ". . . are available to one against whom an action at law is brought on a contract declared voidable by common law. On principle, we see no reason why such defenses would not likewise be available to one against whom an action is brought on a contract declared voidable by judicial construction of a statute. There is nothing in the language of Section 771 or its legislative history to indicate that Congress intended to create a right enforceable in law or in equity not subject to defenses available at law or in equity to an action based on a voidable contract. The silence of Congress cannot be construed as an intention to make such defenses unavailable." 289 F.2d at 373-374.

The court concluded that this reasoning was "also applicable to an action brought under Sections 10(b) and 29(b) of the Securities Exchange Act of 1934." (*Id.*).

This Court in *Mills* emphasized that the interests of the victim are sufficiently protected by giving him the right to rescind. 396 U.S. at 388. The court below also recognized that Associates had a right to rescind. It found, however, that Associates had abandoned that right because it failed to act with "reasonable dispatch." (Pet. App. at 21a). The court below pointed out that

> "Associates was clearly aware of the problems relating to Virginia Surety by at least the early part of 1970. By the summer of 1970, Associates had held meetings with Occidental concerning these problems, and thus was chargeable with notice of misstatements and concealments of Occidental. Yet the first mention of rescission took place in Associates' motion to amend its answer and counterclaim in November of 1972." (Pet. App. at 21a-22a).

Accordingly, the court held that "the passage of two and one-half years [cannot] be deemed to show reasonable diligence." (Pet. App. at 21a-22a). The court also recognized that "the delay in this case is particularly onerous since Associates continued to run Virginia Surety as it saw fit." (*Id.*). The court's holding was consistent with its prior holdings on the same issues in *John Hopkins University* v. *Hutton*, 488 F.2d 912 4th Cir. (1973), and *Baumel* v. *Rosen*, 412 F.2d 571, 575 (1969) *cert. denied* 396 U.S. 1037 (1970).*

Associates, having elected to retain its ownership of Virginia Surety and all the benefits of that ownership for over four

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*Associates, recognizing that its claim for rescission would be barred by *Baumel*, argues that Section 12(2) gives it an *absolute* "statutory (not equitable) right of rescission." But *Straley* involved an action under Section 12(1), which affords remedies identical to those provided by Section 12(2), and makes clear that there is no such "absolute" right.

years, must be held as a matter of law to have waived any right which it might otherwise have had to rescind its purchase of Virginia Surety. And the court below so held. Absent rescission Associates cannot bar enforcement of its promise to pay for Virginia Surety. Any contrary result would be both inequitable and in conflict with this Court's command that "the courts are to be guided by the overriding general policy, as Mr. Justice Holmes put it, 'of preventing people from getting other people's property for nothing when they purport to be buying it.'" *Kelly* v. *Kosuga*, 358 U.S. 516, 520-21 (1959).

The court below also found a direct analogy between the case at bar and this Court's decision in *A. C. Frost & Co.* v. *Coeur D'Alene Mines Corp.*, 312 U.S. 38 (1941). This Court there made clear that non-enforcement of a contract does not automatically follow from a violation of the federal securities laws, stating:

> "The rule that contracts in contravention of public policy are not enforceable . . . 'should be applied with caution and only in cases plainly within the reasons on which that doctrine rests.'" 312 U.S. at 44.

Associates' attempt to bar enforcement of its contract with Occidental underscores the need for the "caution" expressed by this Court in *Frost* and demonstrates the wisdom of the court below in seeking the adoption of sensible remedies which will produce equitable results. To bar enforcement of Occidental's contract solely because of a violation of the federal securities laws could create a remedy measured by the amount of credit extended rather than by the extent of damages suffered as a result of the violation. As one commentator has noted with respect to the "illogic" of such a remedy:

> "[A] defense allowed primarily to enforce the statutory duties of the plaintiff need not embrace a sanction which exceeds the gravity of the harm it is seeking to deter. The illogic of so sweeping a remedy is particularly acute when

> the defense is posed in a suit for the agreed price of shares previously transferred. Its measurement then depends solely on the amount of credit extended, a factor wholly unrelated to the asserted illegality." Note, *Enforceability of Underwriting Contracts Illegal Under the Securities Act of 1933*, 73 HARV. L. REV. 1345, 1354 (1960).

In its Petition, Associates argues that the court below misunderstood *Frost* because that case arose under the Securities Act of 1933 which does not have Section 29(b) among its available remedies. But as the court below recognized, Section 29(b) merely incorporates the common law principles recognized in *Frost*. This Court's emphasis in that case of the duty of the courts to carry out the legislative mandate by choosing among available remedies to produce a sensible and equitable result is as applicable to actions under the Exchange Act as it is to actions under the Securities Act of 1933.

Associates' attempts to distinguish *Mills* by limiting that decision "to the unusual facts there presented." (Pet. at 14). But as suggested by *Mills*, Associates' interests are well and sensibly protected by the award of damages which fully compensated it for all injuries flowing from the violation. Just as in *Mills*, there is no basis for depriving the courts in this case of the flexibility to fashion the equitable remedies that effectuate the purposes of the federal securities laws.

Associates argues that a conflict exists among the Circuits because some courts have voided transactions and held them unenforceable under Section 29(b). But no case relied upon by Associates involved a buyer who adopted and retained the benefits of a transaction while seeking to bar enforcement of its obligation to pay.

Contrary to Associates' assertion, *Sundstrand Corp.* v. *Standard Kollsman Industries, Inc.*, 488 F.2d 807 (7th Cir. 1973) is not a case "almost identical" to this one. (Pet. at 11). In *Sundstrand*, unlike Associates, the buyer promptly "sought as relief a rescission of the transfer." 488 F.2d at 809. It did not seek, as Petitioner seeks here, to keep the securities while

repudiating its contractual obligations to pay for them. Similarly, in *Goldman* v. *Bank Commonwealth*, 467 F.2d 439 (6th Cir. 1972) and *Serzysko* v. *Chase Manhattan Bank*, 290 F. Supp. 74 (S.D.N.Y. 1968), also relied upon by Petitioner, the buyers did not seek to retain securities purchased. Absent such prompt rescission the courts have not permitted voiding of the contract. As the court in *Goldman* pointed out "The courts have not particularly favored a person who seeks to avoid payment of his debts by asserting the defense of illegality." 467 F.2d at 447. Neither should this Court favor Associates' efforts to invoke Section 29(b) to avoid payment of its debt. As this Court noted in *Mills*, "to regard the contract as void where he has not invoked that right [of rescission] would only create the possibility of hardships to him or others without necessarily advancing the statutory policy of disclosure." 396 U.S. at 388.*

Associates apparently recognizes that the result it seeks of treating the contract as a nullity under Section 29(b) would hardly be equitable. It attempts to ameliorate that harsh result by suggesting that perhaps the court could award Occidental some additional compensation. But, as the court below noted:

> ". . . [T]his case presents no basis for use of a quasi-contract theory of recovery. Associates had the option to affirm the contract and sue for damages, or it could elect to rescind." (Pet. App. at 20a).

Associates cannot keep Virginia Surety while repudiating its contractual obligation to pay for it. That, however, is precisely the harsh and inequitable result they seek from this Court.

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*Associates relies on the dictum in *Mills* where the Court stated that "the guilty party is precluded from enforcing the contract against an unwilling innocent party. . . ." 396 U.S. at 387. After having accepted and retained all the benefits of Occidental's performance, with knowledge of Occidental's fraud, for over four years, Associates can hardly be characterized as an "unwilling innocent party" to the contract.

II.

The Court of Appeals Properly Refused to Interfere With the Trial Court's Exercise of Discretion in Setting Aside the Verdict of the First Trial.

A. *The Court of Appeals, in Reviewing the Trial Court's Exercise of Discretion, Applied the Same Standard Adopted by this Court and Other Courts of Appeals.*

The court below held that its review of the trial court's decision to set aside the verdict in the first trial and to grant a new trial was "limited to ascertaining whether the decision amounts to an abuse of discretion." (Pet. App. at 12a). The court below, after examining the record with respect to the evidence of damages, could not conclude that the trial court abused its discretion in finding that the first verdict of $797,000 was excessive. (*Id.*).

Petitioner urges that this Court grant certiorari on the ground that the court below adopted an improper standard and procedure for review of the trial court decision. In fact, the standard applied by the court below, that its function was limited to a determination of whether the trial court had abused its discretion, is precisely the well-established standard followed by this Court and other Courts of Appeals.

There can be no question that the grant of a new trial by a federal trial judge does not contravene the Seventh Amendment. As Judge Parker in *Aetna Casualty & Surety Co.* v. *Yeatts*, 122 F.2d 350 (4th Cir. 1941), said:

> "The exercise of this power is not in derogation of the right of trial by jury but is one of the historic safeguards of that right." 122 F.2d at 353.

This Court has itself implicitly recognized the constitutionality of this power of the trial court as applied to excessive damages in

Montgomery Ward & Co. v. *Duncan*, 311 U.S. 243 (1940), where it held that

> "[T]he motion for a new trial may invoke the discretion of the court in so far as it is bottomed on the claim that the verdict is against the weight of evidence, that the damages are excessive, or that, for other reasons, the trial was not fair to the party moving. . . ." 311 U. S. at 251.

This Court has also made clear that the decision of a trial judge upon a motion for a new trial is not subject to review either by this Court or the circuit courts, absent an abuse of discretion. Thus in *United States* v. *Socony Vacuum Oil Company, Inc.*, 310 U.S. 150, *rehearing denied* 310 U.S. 658 (1940), this Court, having found no abuse of discretion by the trial court, refused to interfere with the discretion of the trial court in denying new trials to certain defendants, stating:

> ". . . [T]his case falls within the well established rule that neither this Court nor the Circuit Court of Appeals will thereafter review the action of a federal trial court in granting or denying a motion for a new trial for error of fact, since such action is a matter within the discretion of the trial court." 310 U.S. at 247.

See, also, Fairmont Glass Works v. *Cub Fork Coal Company*, 287 U.S. 474, 481 (1933) where Judge Brandeis held that

> "The rule [that this court will not review the action of a federal trial court in granting or denying a motion for a new trial] . . . precludes likewise a review of such action by a Circuit Court of Appeals."

This Court's opinions in *Socony Vacuum Oil* and *Fairmont Glass Works* make no distinction between the grant or denial of a new trial in describing the limited role of appellate courts in reviewing the trial court's decision. Nevertheless, Petitioner suggests that a special standard for appellate review

should be applied in cases where a new trial is ordered because the size of the jury verdict is contrary to the weight of evidence. (Pet. at 18). In fact, however, the decisions of the several Courts of Appeals are uniform in holding that, in these as in other cases, the appellate court may reverse the trial court's grant of a new trial only where it is clear that the trial court abused its discretion. *See, e.g., Holmes* v. *Wack*, 464 F.2d 86 (10th Cir., 1972); *Mooney* v. *Henderson Portion Pack Co., Inc.*, 339 F.2d 64 (6th Cir. 1964). In *Holmes* v. *Wack*, the Court of Appeals for the Tenth Circuit refused to interfere with the trial court's exercise of discretion in setting aside an excessive jury verdict, stating:

> "It is clear . . . that a federal trial judge has a broad discretion in the area of granting or refusing to grant a motion for new trial, and the decision of a district court judge will not be reversed absent a gross abuse of discretion." 464 F.2d at 89

Indeed, Petitioner's attempt to find a conflict between the standard for review applied by the court below and the standard applied by the courts in other circuits is sharply contradicted by the very cases cited by Petitioner in support of the purported conflict. (Pet. at 19). For example, in *Manning* v. *Altec, Inc.*, 488 F.2d 127 (6th Cir. 1973), the court plainly stated that "the action of a trial court in granting a new trial on the ground that a verdict is excessive is subject to review only for abuse of discretion. . . ." 488 F.2d at 131.

Similarly, in *Taylor* v. *Washington Terminal Co.*, 409 F.2d 145 (D.C. Cir. 1969), *cert. denied* 396 U.S. 835 (1969), the court stated that the trial court's "exercise of discretion in granting the motion is reviewable only for abuse." 409 F.2d at 149. And in *Lind* v. *Schenley Industries, Inc.*, 278 F.2d 79 (3d Cir. 1960), *cert. denied* 364 U.S. 835 (1960) the court made clear that reversal is possible only "if an appellate court is shown special or unusual circumstances which clearly indicate an abuse of discretion. . . ." 278 F.2d at 88. The court emphasized that

"appellate courts rarely find that the trial court abused its discretion." (*Id.*)

It is quite obvious that Petitioner seeks certiorari from this Court, not to review the standard applied by the court below, but to impose upon this Court the burden of scrutinizing the record before the trial court in the hope that this Court might see fit to substitute its evaluation of the evidence for those of both the trial court and the Court of Appeals for the Fourth Circuit. The decisions of this Court make clear that such a review is not proper and, even if this Court should evaluate the record, the record would clearly support the decision of the court below.

B. *The Trial Court Did Not Abuse Its Discretion in Concluding That the First Jury's Award of $797,000 "Was So Grossly Contrary to the Weight of the Evidence as to Be Shocking to the Conscience of the Court."*

Contrary to Petitioner's contention, this is not a case in which the trial judge deprived a litigant of "a reasonable and proper jury verdict on the question of the amount of his damages. . . ." (Pet. at 25). It is patently obvious that in the first trial Associates failed to introduce competent evidence of damages causally related to Occidental's violation and that the first jury simply failed to follow the trial judge's instruction on damages. As a consequence, the amount awarded as damages, $797,000, bore no rational relationship to any evidence of actual damages suffered by Petitioner as a result of the violation of Rule 10b-5 found by the jury.

1. A plaintiff in a Rule 10b-5 action is limited to recovery of actual damages proximately caused by the Rule 10b-5 violation.

Section 28(a) of the Exchange Act, 15 U.S.C. § 78bb(a) (1970), explicitly limits recovery of damages for any Exchange Act violation, including Rule 10b-5, to the losses which plaintiff has actually sustained as the proximate result of the violation.

Section 28(a) makes unmistakably clear that no person is entitled to recover "in excess of" his "actual damages," and such "actual damages" must be "on account of the act complained of." Failure to show "actual damages" is "a fatal defect in the cause of action based on the Securities Exchange Act of 1934. . . ." *Estate Counseling Service Inc.*, v. *Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 303 F.2d 527, 533 (10th Cir. 1962).

This means, in short, that a plaintiff in a Rule 10b-5 action is limited to those "actual damages" proximately caused by the Rule 10b-5 violation. Such result is consistent with the well-settled principle that a private right of action under Rule 10b-5 "lies in tort and not on contractual grounds." *Myzel* v. *Fields*, 386 F.2d 718, 744 (8th Cir. 1967), *cert. denied* 390 U.S. 951 (1968). To recover under traditional concepts of damages in fraud actions "it must appear, not only that injury has been suffered, but that the fraud complained of was the proximate cause of the injury." *Boatman's Nat'l Co.* v. *M. W. Elkins & Co., Inc.*, 63 F.2d 214, 216 (8th Cir. 1933).

The requirement is no different in Rule 10b-5 actions. In *Myzel* v. *Fields, supra*, the court specifically affirmed that in Rule 10b-5 actions, as in common law fraud actions, "to be recoverable the damages must be proximately caused by the defendants." 336 F.2d at 744.

In *Baumel* v. *Rosen*, 412 F.2d 571, 576 (1969), the Court of Appeals for the Fourth Circuit specifically held that "while a defrauding party is not to be excused, neither is he to be punished," and that in Rule 10b-5 actions "[a] fair attempt to compensate for wrongs is the aim." Similarly, in *Green* v. *Wolf Corp.*, 406 F.2d 291, 303 (2d Cir. 1968), *cert. denied* 395 U.S. 977 (1969), the Court of Appeals for the Second Circuit said that it did "not believe that Congress intended the Securities and Exchange Act [sic] to be used as a vehicle for recovery of judgments that could often be grossly disproportionate to the harm done." That is why, said the Second Circuit, Section 28(a) of the Exchange Act specifically limits a plaintiff's recovery in Rule 10b-5 actions to "actual damages."

2. The first jury failed to follow the trial court's specific instruction that Petitioner's recovery was to be limited to those actual damages proximately caused by Occidental's Rule 10b-5 violations.

Petitioner, at page 22 of its Petition, purports to set forth the trial court's charge to the jury on damages during the first trial. Petitioner, however, fails to mention that the very first sentence of the charge stated:

> "The party injured by any violation of these statutes or rules may recover *any loss proximately resulting therefrom.*" (Tr. I, 11/17/72 at 141). (emphasis added).

Before reaching its verdict, the jury returned to the courtroom for a clarifying instruction. The trial judge again reiterated to the jury that

> "The party injured by any violation of the statute or rule may recover *any loss proximately resulting therefrom.*" (Tr. I, 11/17/72 at 150). (emphasis added).

The first trial jury was not, as Petitioner asserts, "*required* by the instructions of the court to return a verdict for exactly the amount awarded." (Pet. at 22). To the contrary, the jury could have returned a damage award for that amount only by failing to follow the court's instructions. That fact, standing alone, fully authorized the court to grant a new trial. For it is beyond reasonable dispute that the figure, $797,000, bore no relationship to "actual damages" proximately caused by Occidental's alleged Rule 10b-5 violations.

Indeed, there is no guesswork whatsoever as to how the jury reached its verdict. It simply determined that it would "cancel out" the trial court's direction of a verdict in Occidental's favor of $770,000, representing the unpaid balance due on the contract price, and award an additional $27,000 to Petitioner as "actual damages." This is not a matter of speculation because, just before returning its verdict, the jury returned to the courtroom to ask the following question of the trial judge:

> "Foreman: Your Honor, we have a question as a matter of clarification about the stated question on this white

> sheet here, reading 'what amount of damages, if any, is defendant entitled to recover on its counterclaim?' And the question we have is is [sic] the figure that we put here, if we put one here, will that be a figure independent of the $700,000 [sic $770,000] which Mr. Ryan owes according to the terms of the contract? *Or would this figure be an amount that would not tend to cancel out this claim?"* (Tr. I, 11/17/72 at 148-149). (emphasis added).

But the jury was not entitled to "cancel out" the directed verdict and thereby relieve Petitioner of its contractual obligation. It was charged with the duty of determining from the evidence what Petitioner's "actual damages" were proximately resulting from Occidental's alleged Rule 10b-5 violations. Petitioner's obligation to pay the balance due on the contract, $770,000, was not a measure of Petitioner's "actual damages." By hinging its award on that figure, the jury reached a verdict that was legally improper and grossly disproportionate to the "actual damages" which Petitioner suffered, as the trial court correctly discerned.

Petitioner attempts to argue that the $797,000 damages awarded in the first trial relate to its "actual damages" by asserting that it "agreed to a purchase price far in excess of the value of the stock, in return for an arrangement (the reinsurance agreement) under which a major portion of the price could be satisfied by a transfer of business to the seller, rather than with cash." (Pet. at 24). On this basis, Petitioner contends that the trial court's directed verdict on the breach of contract action forced the transaction into a straight cash deal at an excessive price.

Petitioner's argument assumes that the reinsurance arrangement whereby the $770,000 unpaid portion of the purchase price could be satisfied by a transfer of business rather than with cash would have cost it nothing. Such an assumption defies common sense! If Petitioner could have paid the unpaid balance of the purchase price, with no cost to it, why would it not fulfill its contractual obligations and then recover, in cash, the damages allegedly caused by Occidental's fraud? Instead

it chose, as no rational businessman would, to repudiate that allegedly "no cost agreement" and to expose itself to substantial liability for breach of contract.

Petitioner did not merely agree to pay $770,000 to Occidental through reinsurance agreements. It also specifically guaranteed that if, for any reason, it failed to perform under the reinsurance agreement, it would pay Occidental the $770,000 in cash. It is beyond dispute that Petitioner failed to make those payments in breach of its contract with Occidental.

3. Moreover, Petitioner failed to introduce any evidence of actual damage in the first trial.

The record of the first trial is barren of any evidence of "actual damages" despite the fact that Petitioner clearly carried the burden on that issue. Petitioner never sought to establish the extent to which, if any, the alleged wrongful acts of Occidental caused Virginia Surety to be worth less than the agreed-upon price for Virginia Surety. Indeed, Petitioner contends that the agreed-upon price for Virginia Surety is an irrelevancy and no measure whatsoever of the "fair market value" of Virginia Surety, defect-free, at the time of sale.

The "fair market value" for any property, however, is that amount which a willing buyer will pay a willing seller for the property in an arms-length transaction. *Corbin on Contracts* § 127 (one vol. ed. 1952). Associates and Occidental made their own contracts and by contract fixed the "fair market value" for Virginia Surety in the amount of $2,297,000.

Petitioner is not entitled, as it seeks, to disregard its own contract valuation in establishing how much less Virginia Surety is worth on account of the alleged defects. To do so is to renegotiate the contract price of Virginia Surety at some hypothetical "fair market valuation," irrespective of the damage caused by Occidental's alleged violations. That is precisely what Petitioner's expert witness did when he placed the fair market value of Virginia Surety at $1,500,000. Petitioner's figure of $1,500,000 is, therefore legally meaningless as evidence of the "actual damages" suffered. It is not evidence of what Petitioner would have been willing to pay in the light of its own needs and circumstances for Virginia Surety with defects. It is an opinion

wholly unrelated to the needs and circumstances of Petitioner which, in fact, agreed to pay $2,297,000 for a defect-free Virginia Surety.

Petitioner has never alleged, nor is there any evidence to show, that Occidental falsely represented the fair market value of Virginia Surety. What Petitioner is really contending is that it paid too much for Virginia Surety, entirely aside from the alleged misrepresentations, and should, therefore, be relieved of its contractual obligations. The court below properly refused to permit such a result, stating:

> "Associates' real quibble is that it paid an allegedly inflated price for a defect-free Virginia Surety. That may show poor business acumen on Associates' part, but utterly fails to show any windfall profits." (Pet. App. at 15a).

4. The trial court properly found the jury's $797,000 damage award shocking to its conscience because, under any rational hypothesis, Petitioner's actual damages could not have approximated that figure.

It is apparent from the record of the first trial that Petitioner's "actual damages" could not have remotely approached $797,000. If Petitioner had obtained everything it contends that it was entitled to, it would have received a "shell" corporation with no liabilities but with capital and surplus, represented by bonds on deposits with state insurance regulatory agencies, and licenses to conduct an insurance business in 50 jurisdictions. The parties specified in the October 22 agreements of sale that the value of the capital and surplus was $1,326,717.70. Thus, even if all 50 of the licenses conveyed had been worthless, or not even conveyed at all, Petitioner still would have received assets valued at $1,326,717.70.

Thus, the 50 licenses were conveyed at a contract price valuation of $970,282.30.* Associates contends that five of the

*The figure of $970,282.30 represents the difference between the contract price of $2,297,000 and $1,326,717.70 for capital stock and surplus. That figure of $970,282.30 is necessarily the value which the parties placed upon the corporate charter and 50 licenses, since, apart from the capital and surplus, nothing else was conveyed.

50 licenses were defective to a greater or lesser extent, *i.e.*, the licenses for California, Michigan, Connecticut, Maryland and North Carolina. There is no contention that the licenses in the other 45 jurisdictions contained any defects whatsoever.

Under any hypothesis, it is rationally indefensible to suggest that the five allegedly defective licenses should be assigned a valuation of $797,000, or $160,000 per license, while the remaining 45 non-defective licenses only deserve a total valuation of $173,000, or $3,850 per license. Nothing in the record supports such an absurd disparity. Accordingly, the trial court was fully warranted in setting aside the first jury award of $797,000 as excessive and contrary to the clear weight of the evidence. The court below was equally justified in refusing to interfere with the trial court's exercise of discretion.

CONCLUSION

For the reasons set forth above, the Petition for a Writ of Certiorari should be denied.

Respectfully submitted,

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